IN THE

Supreme Court of the United States

OCTOBER TERM 1975

No. 75-922

BANKERS TRUST CO., et al., *Petitioners*

v.

UNITED STATES OF AMERICA, *Respondent*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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CITATIONS

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The petitioners, Bankers Trust Company, Francis D. Butler, Gilbert M. Haas, Earl Knudsen, and Norman F. Sprague, Jr., as Trustees of the Mesabi Trust and Transferees of the assets of Mesabi Iron Company, repectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Claims entered in this proceeding on July 11, 1975.

OPINION BELOW

The opinion of the Court of Claims and Judge Kashiwa's dissent are reported at 518 F.2d 1210 and appear, with the Findings of Fact of the Court of Claims, not officially reported, in the Appendix hereto.

JURISDICTION

The judgment of the United States Court of Claims was entered on July 11, 1975. A timely petition for rehearing was denied on October 3, 1975, and this petition was filed within ninety days of that date. This Court's jurisdiction is invoked under 28 U.S.C. section 1255(1).

QUESTION PRESENTED

Is the value of stock received by a corporation in settlement of litigation to be measured for federal income tax purposes by the trading price (a) on the date the parties reached the settlement agreement and measured its economic and tax consequences, or (b) only later on the date of formal approval by the shareholders of the corporation?

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Code, Title 26:

§ 61 Gross income defined

(a) General definition—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived . . .

Treasury Department Regulations

§ 1.61-1(a) . . . Gross income includes income realized in any form, whether in money, property, or services. Income may be realized, therefore, in the form of services, meals, accommodations, stock, or other property, as well as in cash. . . .

STATEMENT OF FACTS

The petitioners are the trustees of the Mesabi Trust, the successor to Mesabi Iron Company ("Mesabi") (F. 1) [1] This case arises out of the settlement in 1960 of litigation between Mesabi and Reserve Mining Company ("Reserve"), then a 12% shareholder in Mesabi, in which Reserve surrendered its Mesabi stock. As a result of the surrender, Mesabi was required to report additional taxable income on its 1960 federal income tax return.[2] The issue is whether Mesabi's income is to be measured by the market price of the stock when the settlement agreement was reached or by the price on the day the agreement was formally approved by the Mesabi shareholders.

Mesabi owned extensive leases that gave it mining rights in several tracts in the Mesabi Iron Range in northern Minnesota. Early operations on those leases were unprofitable, chiefly because the technology of the day did not permit the low grade ores in Mesabi's leased lands to be smelted profitably. (F. 3-4) In 1939 Mesabi agreed to assign its leases to Reserve in exchange for a cash payment and a royalty of one-third of the net profits from the leases. (F. 5-7) Shortly thereafter Reserve acquired on the open market approximately 12% of Mesabi's stock. (F. 8-9)

In the early 1950's Reserve installed equipment permitting the use of newly developed methods for concentrating and processing the low content ore, and in 1956 began large-scale mining on the leased lands. (F. 11-12) All the ore produced was sold to the two major

[1] References in the Statement of Facts in the form "F. —)" are to the Court of Claims' Findings of Fact (App. 34a-64a).

[2] A corresponding deduction was also available to Reserve.

steel companies that were, by that time, Reserve's sole and equal owners. (F. 13)

Differences arose between Mesabi and Reserve over computations of expenses and income for purposes of calculating the royalties due to Mesabi. (F. 14) In numerous lawsuits and proceedings in various forums and in arbitration proceedings, Mesabi charged that Reserve had failed to pay sufficient royalties under the 1939 agreement, had violated the anti-trust laws in its sales of the products of the mining operations, and had acquired its interest in Mesabi illegally. (F. 20-29) Mesabi's objectives were to eliminate Reserve's stock interest in Mesabi and to substitute a royalty based on a fixed charge per ton for the net profit royalty. (F. 30) In late 1959, Reserve initiated talks aimed at settlement of all disputes. (Affidavit of Gilbert M. Haas, 7)

After intensive talks, "[o]n February 18, 1960, the negotiators reached an agreement" (App. 6a) that was approved by the directors of each corporation on February 19. (F. 33) The principal terms of the settlement were that Reserve would pay Mesabi $400,000, would surrender its Mesabi stock to Mesabi, and would in the future pay royalties on the basis of a formula that resulted in a fixed, per-ton royalty. In return, Mesabi agreed to dismiss its various lawsuits and treat its royalty claims for years prior to 1960 as satisfied. (F. 34, 39)

The agreement also provided that its provisions were "subject to the approval of the stockholders of Mesabi". (F. 39, ¶ 8) This was not required under the laws of the state of Delaware, where Mesabi was incorporated, as the directors had the authority to enter into the settlement agreement without shareholder ap-

proval and the provision was included at Reserve's insistence. (Dissent, App. 29a; F.41; Tr. 71-72). Mesabi's board of directors were obligated to recommend approval, to use their best efforts to secure the maximum vote, (F. 39, ¶ 6) and to suspend all litigation immediately. (F. 39, ¶ 7)

Both Reserve and Mesabi were certain that such approval would be forthcoming. Gilbert M. Haas, Secretary-Treasurer and a director of Mesabi, who played a leading part for Mesabi in the negotiations, stated in his answers to interrogatories:[3]

> Mr. Arnold Hoffman [president of Mesabi] and I were in constant communication with the principal shareholders of Mesabi, and as a result of our close contact with the shareholders we were able to assure the officers of Reserve, that the shareholders of Mesabi would overwhelmingly accept and approve the terms of a Settlement Agreement recommended by the Mesabi Board of Directors. In fact, it was not until after I personally assured Mr. William Bryant, an officer of Reserve, in December 1959 that it was an absolute certainty that the shareholders of Mesabi would accept and approve the terms of any settlement recommended by the Mesabi Board of Directors, that negotiations for settlement were initiated and seriously pursued by Reserve.

Immediately after the Mesabi board's approval of the agreement, Haas personally contacted owners of more than the required majority of the shares and confirmed that they would vote for the agreement.[4]

[3] The text of the portion of Haas' Answers to Interrogatories that deals with this issue is quoted in Judge Kishiwa's dissent at App. 31a-32a.

[4] App. 32a-33a.

In the Mesabi board's consideration of the settlement proposal on February 19, the current price of Mesabi's stock on the American Stock Exchange was a central factor, although not explicitly mentioned in the agreement or discussed with Reserve. The Mesabi board was informed by counsel that the maximum reasonable expectation of recovery on the royalty claims was $7,000,000 and that, since this was roughly the value of the Mesabi stock to be surrendered by Reserve measured by its February 18 price of $40-3/8 on the American Stock Exchange, the settlement was a complete victory on the royalty claims. (F. 35-36) The directors also referred to the stock price in considering the tax effects of the settlement. (F. 36; Tr. Exh. B) They were advised by counsel that the maximum additional income attributable to the receipt of Reserve's stock would be $7,000,000, based on the price at which Mesabi stock had traded the day before—$40-3/8. After consideration of these and other implications of the settlement, the Mesabi board unanimously approved it on February 19, as did Reserve's directors and its two shareholders. (F. 33)

The next day, February 20, Mesabi publicly announced that a settlement had been reached, briefly outlining the details of the agreement, and reports were carried in newspapers on February 22nd and 23rd. (F. 37; Stip. Exh. 37) On March 22 and 23, press stories reported Mesabi's plans to transform itself into a trust to avoid double taxation. (Stip. Exh. 39) On April 7, Reserve announced plans greatly to expand its production from the Mesabi property after the settlement was finally approved. (Stip. Exh. 40) "As a result of these activities numerous brokerage houses recommended Mesabi stock as a good investment" on

the basis of the favorable royalty payments, possible change in corporate structure, and Reserve's expansion plans. (F. 37) Another important stimulus to increase the price was Mesabi's publicly announced projection of quadrupled earnings under the new royalty arrangement. (Stip. Exh. 43(a), p. 11) The trading prices for Mesabi's shares moved up sharply during the period between announcement of the settlement agreement and the shareholder vote on April 22, reaching a closing price on April 21 of $82-3/4. (F. 49)

On April 22, 1960, in a vote in which holders of 87% of the eligible shares participated, Mesabi's shareholders approved the proposed settlement agreement by the overwhelming vote of 1,016,049 shares to 970. In accordance with the agreement, Reserve's 163,570 shares were not voted. (F. 43) The dismissal of suits, payment of the $400,000, and transfer of Reserve's Mesabi stock were then carried out, with the process completed on April 27. (F. 44-45)

In its federal income tax return for 1960, Mesabi reported $7,066,042 royalty income from the transaction. This amount was computed on the basis of the $40-3/8 February 18 market price of the stock surrendered, *i.e.,* the value considered by the Mesabi board when it approved the settlement agreement, less a $4.25 per share blockage discount based on advice of an independent investment banking firm. On audit, the Internal Revenue Service increased Mesabi's income an additional $7,717,323.60, on the sole ground that the stock should have been valued at its mean market price on the day of the shareholders' vote. Petitioners paid the additional tax resulting from this adjustment, $3,016,132.64, plus $305,579.68 in interest, and sued in

the Court of Claims for a refund, pursuant to 28 U.S.C. section 1491.

The Court of Claims, Judge Kashiwa dissenting, rejected petitioners' position, holding that since Mesabi's income from the stock accrued only on April 22 after the shareholders voted, the value of the stock must also be measured by its trading price on that day.

REASONS FOR GRANTING THE WRIT

1. The Court of Claims' decision (a) ignores the basic federal income tax principle enunciated by this Court that properties exchanged in a transaction "are either equal in fact or are presumed to be equal" and, by doing so, (b) applies an unrealistic measure of income for purposes of calculating the tax and (c) makes it impossible for taxpayers to foresee the income tax effects of agreements into which they enter.

In American business transactions, publicly traded stock is frequently used as the consideration for a transfer of assets. In such transactions there is normally an interval between the time an agreement is reached and the final consummation. Such transactions often involve, as does this one, millions of dollars. The Court of Claims' decision should be reviewed by this Court because it will create an unnecessary element of confusion and uncertainty in determining the business and tax consequences of a great many similar business transactions.

The vital economic fact of this case is that on February 19, 1960, following extended arms-length negotiations, the boards of directors of Mesabi and Reserve approved an agreement settling long-standing litigation between them, mainly in consideration of the transfer to Mesabi of 163,750 shares of Mesabi common stock.

By approving the agreement, the directors of each company, experienced businessmen with intimate knowledge of the consideration passing to each party under the agreement, determined that the proposed settlement was fair from the standpoint of their respective companies, *i.e., that the various properties being exchanged were equal in value.*

The record shows that in reaching that conclusion the directors of Mesabi relied upon—and could only have relied upon—the trading price of the Mesabi shares on the American Stock Exchange on the previous day. With knowledge that the price was $40-3/8, the Mesabi directors agreed to the transaction and undertook to recommend approval to the Mesabi shareholders and to use their best efforts to obtain approval. In light of their continuing close contact with key shareholders, they were certain of a favorable vote and had given Reserve assurances to that effect.

In reaching their decision, the Mesabi directors also considered the tax effects of the settlement. Those tax effects were obviously a critical factor in any judgment to approve the settlement. Here again, the record demonstrates that the Mesabi board relied upon the trading price for the shares on the day preceding the date the agreement was reached. In business parlance, both sides made a deal at that time and, in doing so, made judgments on its economic and tax impact based upon the market price on that date.

The Internal Revenue Code imposes tax only on a taxpayer's "income". This Court in *United States* v. *Davis,* 370 U.S. 65, 72 (1962), recognized that, in determining the amount of income from an arms-length exchange, the value of the properties exchanged "are

either equal in fact or are presumed to be equal".[5] Such a rule simply reflects economic reality. The fact of agreement not only demonstrates that the values were equal, but that they were equal at the time the agreement was reached; for only at that time could the negotiators have determined that the property being received was at least equal in value to the property being surrendered. In economic terms, therefore, the only realistic measure of income from such an exchange is the value of the property *at the time the agreement to exchange is reached.*

Yet, the Court of Claims' decision measures Mesabi's income by the trading price of the shares on a day two months after the agreement was reached.[6] Thus, though this Court has ruled that the values of the

[5] The language quoted is from the Court of Claims' opinion in *Philadelphia Park Amusement Co.* v. *United States,* 126 F. Supp. 184, 189 (1954), and was quoted with approval by this Court in *Davis, supra* at 72.

[6] At trial, petitioners conceded that the income from receipt of the stock accrued only in April, but argued that the income received in April was measured by the value in February when the settlement was agreed upon with Reserve. (Mesabi's concession on that point of law was withdrawn in a motion for rehearing.) In its opinion, the Court of Claims relied heavily on the concession as to accrual date, saying that in light of it, Mesabi's valuation argument "runs counter to the basic principle that under the federal income tax system items are taken into income at their then current value." As the Court of Claims recognized, no statute or regulation states that "basic principle." Thus, there is no question here of deferring to administrative expertise in the tax area; rather "the problem here involves an interpretation of the meaning of 'value' . . . unaided by an interpretative regulation." *Guggenheim* v. *Rasquin,* 312 U.S. 254, 258 (1941). The regulations cited by the Court of Claims deal with specific situations in which no basis normally exists for questioning whether the value of the property received as income should be measured at any time other than as of the date on which the income accrued.

consideration are presumed to be equal (as in the real world they almost surely are), and though that rule requires logically that the value be measured as of the time of agreement, the Court of Claims has adopted a rule under which the income from an exchange can fluctuate wildly long after the bargain has, in practical terms, been reached.[7]

The arbitrary effect of that rule in this case is to tax Mesabi on the basis of a value almost twice that contemplated by the two boards of directors when reaching the agreement. That value used by the Court of Claims can be the correct measure of Mesabi's economic income only if one believes that its litigation claims doubled in value after they had already been settled—which is obviously absurd.

The Court of Claims' rule is flatly contrary to the rationale of the *Davis* case, ignores economic reality, and makes it impossible for the parties to foresee the tax consequences of their bargain. Such a rule results in uncertain and erratic taxation and imposes undue hardships on taxpayers in complying with the tax laws.

[7] This Court has also endorsed as the proper definition of "fair market value", the price "at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of the relevant facts." *United States* v. *Cartwright,* 411 U.S. 546, 551 (1973). In this case only when the transaction was agreed upon in February—not when it was formally consummated in April—did these conditions apply, for it was only in February that both parties were "willing", *i.e.,* that they exercised their wills by deciding on the settlement.

2. The Court of Claims' decision is in conflict with a decision of the Seventh Circuit Court of Appeals in a substantially identical case.

The rule adopted by the Court of Claims is inconsistent with the most closely comparable prior decision on this issue, *Herbert J. Investment Corp.* v. *United States*, 360 F. Supp. 825 (E.D. Wis. 1973), *aff'd per curiam,* 500 F.2d 44 (7th Cir. 1974) In that case, the taxpayer, an interstate trucking company, sold its intangible assets in exchange for 100,000 shares of the buyer's stock. Under the applicable provisions of the Interstate Commerce Act, 49 U.S.C. § 310a(b), the ICC was empowered to grant temporary approval to the transfer, pending consideration of whether to grant permanent approval under section 5 of the Act. The parties valued the stock transferred by the market price on the date soon after the temporary approval when the buyer assumed temporary control of the seller's assets, subject to eventual permanent ICC approval of the transfer. The government took the position, however, that the valuation date should be five months later, when the ICC finally granted permanent approval.

The court rejected the government's position. It held that the value at the time of the temporary ICC approval was the correct measure because "the assets exchanged were valued as of that date, and *the parties contemplated their bargain on the basis of the relative worth of those assets at that time.*" 360 F. Supp. at 827 (emphasis added). In *Herbert J. Investment*, as here, the government argued for the later valuation on the ground that the effective date of the sales agreement was deferred until its implementation was approved by others. However, the court, although ac-

knowledging that the permanent ICC approval was "more than a mere formality [because] the purchase could not be final without it," rejected the government's argument, saying:

> . . . the clear intentions of the parties are controlling. . . . The parties . . . utiliz[ed] language which tied consummation of the arrangement with final [ICC] approval. Consummation itself, however, was actually nothing more than formalization of the arrangement effected by the parties on April 1. The parties recognized the importance of final approval, but were so certain of its forthcoming that they *fully committed themselves to the impact of their agreement* on April 1, 1968, and treated the possible failure of final approval as a real, but highly unlikely, condition subsequent. 360 F. Supp. at 827 [emphasis added].

An exactly similar analysis applies here. From February 19 forward Reserve and Mesabi had "fully committed themselves to the impact of their agreement"; and it was on February 19 that the "parties contemplated their bargain on the basis of the relative worth [of the assets exchanged] at that time." Reserve was committed to surrender all its shares irrespective of subsequent changes in the market price. As additional consequences of the February agreement, and before shareholder approval in April, (1) Mesabi suspended its litigation against Reserve and (2) Reserve announced expansion plans, although final implementation of both decisions was deferred pending Mesabi shareholder approval. Here, as in *Herbert J. Investment,* the further approval required before the final legal consummation of the agreement was treated as a formal action, which—although it created a "potential legal impediment" to implementation—"was consid-

ered by the parties, correctly it now appears, remote." 360 F. Supp. at 827. Here also, "Consummation itself . . . was actually nothing more than formalization of the arrangement effected by the parties" on February 19. *Id.*

In fact, in the present case the parties had a far better basis than in *Herbert J. Investment* for dismissing the contingency as remote. In *Herbert J. Investment* further action of an independent government regulatory agency was required after a proceeding with formal notice and consideration of the public interest and the possible rights of other carriers. The ICC was not bound by its temporary approval to give permanent approval. *Falwell* v. *United States,* 69 F. Supp. 71, 75 (W. D. Va.), *aff'd per curiam*, 330 U.S. 807 (1946). Mesabi's board, on the other hand, had every reason to regard shareholder approval of the settlement as a virtual certainty, a "real, but highly unlikely, condition subsequent." [8] Moreover, the directors of Mesabi were obligated to recommend approval and to use their best efforts to obtain approval by the shareholders.

The Court of Claims' attempt to distinguish its result from that of *Herbert J. Investment* simply demonstrates the impractical formalism it brought to the problem. In this case, it found the later price to be appropriate because "no effort was made to close in any way before the vote of the Mesabi stockholders," whereas in *Herbert J. Investment* the parties "effectively closed" their sale on the ICC temporary approval. The Court of Claims also concluded that here "the shareholders' approval was treated throughout

[8] See Judge Kashiwa's dissent, App. 31a-33a, and Statement, *supra*, p. 4-5.

as a most significant condition precedent, not as a condition subsequent as in *Herbert J. Investment.*" In fact, as the *Herbert J. Investment* court explicitly noted, the parties there knew that final ICC approval was essential and was "more than a mere formality," and they deferred "consummation" or closing until it was received.[9] Nevertheless, the court in *Herbert J. Investment*—in contrast to the Court of Claims—used as the measure of income the price, not when the transaction was formally consummated, but "when as a practical business matter the transaction was terminal." The same test should apply here.

3. The Court of Claims refused to follow the decisions of this Court which hold that, in determining "fair market value," the event giving rise to the valuation must not itself affect the value.

Under the Court of Claims' decision, the income received in the transaction is measured by a price that had been dramatically affected by the very fact that the transaction had taken place. The settlement of Mesabi's long-standing dispute with Reserve was promptly announced, as were Reserve's own expansion plans following resolution of the dispute. On the basis of these events—and the announced surrender of Reserve's 12% interest in Mesabi—brokerage houses recommended Mesabi stock for purchase. (F. 37) It was

[9] The Court of Claims buttressed its conclusion by stating that shareholder approval "though probable was surely not a mere formality." Apart from ignoring evidence that Mesabi's management had reason to believe that approval *was* a foregone conclusion, this statement ignores the use in *Herbert J. Investment* of almost exactly identical language to describe the permanent ICC approval as "certainly . . . more than a mere formality." 360 F. Supp., at 827.

those events, all stemming from the February 19 agreement, that produced the nearly doubled price by April 22.[10] The Court of Claims' decision thus produces a classic bootstrap result—making the fact that the agreement had been reached a major determinant of the value of the property that was transferred under the agreement.

This Court has made it clear that where market values are being determined, this "reflexive" element is to be eliminated in order that the event requiring the valuation does not itself affect the valuation. *United States* v. *Miller,* 317 U.S. 369, 375 (1943). See also *United States* v. *Cors,* 337 U.S. 325 (1949). The Court of Claims dismissed the authority of the *Miller* and *Cors* cases on the ground that they are condemnation cases, and it treated the "enhancement" principle as being limited to eminent domain situations. This Court, however, has never suggested that the rule enunciated in those cases is so limited. Indeed, the principle is advanced in the course of the Court's discussion of the proper measurement of "fair market value", *United States* v. *Miller, supra,* at 374; and this Court has expressly stated that "the principles governing the ascertainment of value for purposes of taxation are the same as those that control in condemnation cases, confiscation cases, and generally in controversies involving the ascertainment of just compensa-

[10] There was no general movement in stock prices in that period, as shown by the stability of recognized price averages:

	Feb. 18, 1960	April 22, 1960
Standard & Poor Industrial	60.15	59.09
Composite	56.24	55.42
Dow-Jones Industrial	639.9	630.8
Composite	209.9	207.6

tion." *Great Northern Ry. Co.* v. *Weeks,* 297 U.S. 135, 139 (1936).

The unfairness of permitting the transaction itself to affect the value of the consideration passing in the transaction is especially obvious in this case. Here the issue is the value of the 12% of the common stock of Mesabi which Reserve surrendered to Mesabi. The reduction in outstanding shares taken alone would tend to cause the market price of the remaining shares to rise when, as here, it is accompanied by clear signs that the total earnings of the company will increase following the reduction. Surely the enhanced value of the shares which remained outstanding ought not to be applied to determine the value of the shares surrendered; and any rule of law which produces that result must be seriously in error.

4. The Court of Claims' rule creates an unnecessary and harmful unpredictability and arbitrariness in federal income taxation.

This Court has emphasized the importance of interpreting the federal tax laws so as to provide clear guidance and a basis for reliance for planning transactions, *United States* v. *Byrum,* 408 U.S. 125, 135 (1972), and so as to avoid use in the tax laws of "an unreasonable and unrealistic measure of value." *United States* v. *Cartwright,* 411 U.S. 546, 557 (1973).

Transactions are commonplace where business and tax consequences turn on the value of property which is formally transferred some time after agreement is reached. As in this case, they often involve large sums and affect many shareholders. In such cases, the objectives of predictability and practicality can be served only by making the price at the time of agreement control, even though additional, legally essential but prac-

tically certain steps remain to be taken. The rule adopted by the Seventh Circuit in *Herbert J. Investment, supra*, recognizes—as the Court of Claims does not—that "the government's position would . . . preclude an entity contemplating such a sale from accurately assessing the tax consequences of its proposed actions." [11] In contrast, the Court of Claims' rule prevents taxpayers from reasonably measuring the tax effects of a course of action when they commit themselves to it, and instead forces them into unwilling speculation on future price movements, with wholly arbitrary and capricious calculations of income.

No administrative necessity justifies the Court of Claims' rejection of the practical approach required by this Court's prior decisions and adopted in *Herbert J. Investment. Herbert J. Investment* fixed the date of valuation by a definite event that as a practical matter bound both parties and demonstrated the parties' business determination that their exchange was an equivalent one. Such a definite event was clearly present here in the February 19 agreement. Petitioners do not contend that the government should be bound by an attempt of the parties to fix an arbitrary valuation date

[11] Cf. *C. M. Hall Lamp Co.* v. *United States*, 201 F.2d 465, 468 (6th Cir. 1953), holding that the value of stock received for property is to be determined "at the time when the contract became a binding obligation", not when the certificates were formally made out and delivered:

> The construction contended for by the appellee would result in a variable cost to the taxpayer, subject to subsequent developments over which it had no control, with a resulting uncertain and variable tax liability depending upon whether the market value of the stock advanced or declined in price. A taxpayer should be entitled to predetermine his tax liability in a specific legally completed transaction by a more certain and definite standard than such a variable.

for purposes of the transaction. [12] Nor is there any question here of using anything other than stock exchange prices as the measure of value. Rather, petitioners urge that when a mutual agreement is reached between the parties and "as a practical business matter the transaction [is] terminal" [13] —a clearly identifiable event—taxpayers should be able to look to then current market prices to measure their bargain and to determine the true income and economic and tax consequences of their transaction.

The Court of Claims' opinion suggests that, to overcome the problems created by its decision, taxpayers should carefully draft their agreements so as to make clear that subsequent formalities constitute "conditions subsequent" rather than "conditions precedent." Such a strained and legalistic approach honors form over substance, interferes substantially and unnecessarily with normal business practices, and is inconsistent with an equitable and practical federal tax system. Taxation is a practical matter and the realities of a transaction should govern its tax consequences, not the niceties of legal draftsmanship.

In this matter the government is essentially a stakeholder. Obviously, there will be variations from case to case on whether it would be more advantageous to the revenues to have a higher or lower share value; but

[12] That issue was presented in *Amerada Hess Corp.* v. *Comm'r.*, 517 F.2d 75, (3rd Cir. 1975), cert. denied sub nom. *White Farm Equipment Co.* v. *Comm'r.*, (No. 75-375, Dec. 12, 1975). There the parties agreed in early October to a transaction, one element of which was an agreement to use the price on a date in the previous June to measure the value of stock to be formally transferred later in October.

[13] *Herbert J. Investment Corp.* v. *United States*, supra, at 827.

in the generality of cases, those factors will balance out between the parties. In short, an administratively workable, realistic, and equitable rule is possible with practically no revenue consequences. There is neither legal nor policy justification for the arbitrary rule adopted by the Court of Claims.

CONCLUSION

This case presents a basic issue of federal income tax law of exceedingly broad application. The Court of Claims' decision exalts legal form over economic substance, is inconsistent with tax principles established by this Court, and is in conflict with the decisions of another lower court. Accordingly, the petition should be granted.

Respectfully submitted,

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APPENDIX

IN THE UNITED STATES COURT OF CLAIMS

No. 89-67

(Decided July 11, 1975)

BANKERS TRUST COMPANY, FRANCIS D. BUTLER, GILBERT M. HAAS, EARL KNUDSEN, AND NORMAN F. SPRAGUE, JR., TRUSTEES UNDER AGREEMENT OF TRUST DATED JULY 18, 1961, TRANSFEREES OF THE ASSETS OF MESABI IRON COMPANY, DISSOLVED

v.

THE UNITED STATES

David W. Richmond, attorney of record for plaintiff. *Robert L. Moore, II* and *Miller & Chevalier,* of counsel.

Milan D. Karlan, with whom was *Assistant Attorney General Scott P. Crampton,* for defendant. *Theodore D. Peyser* and *Donald H. Olson,* of counsel.

Before COWEN, *Chief Judge,* DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges.*

Opinion

DAVIS, *Judge,* delivered the opinion of the court:

This action to recover corporate income taxes assessed and paid was brought on behalf of the Mesabi Trust by its trustees, as successor to the Mesabi Iron Company. The taxes were assessed as a deficiency in the Mesabi Company's 1960 return, and all relevant events occurred prior to the July 18, 1961 change to trust status. The company rather than the trust and trustees will be referred to as "Mesabi," "the taxpayer," and "plaintiff."

The disputed tax, amounting to $3,016,132.64 plus interest, arises from a difference between plaintiff and the Internal Revenue Service as to the value of 163,570 shares of Mesabi stock received by the company during 1960 from the Reserve Mining Company. The parties' earlier mo-

tions for summary judgment were denied without prejudice and the case remanded for full development of the facts. 198 Ct. Cl. 306, 459 F. 2d 484 (1972). A trial was held before Trial Judge Lloyd Fletcher who decided in favor of the Government. We now confirm that conclusion.

I

Facts

The events leading to the ultimate transfer of the stock, which are rather complex, are fully set out in the findings of fact made by Trial Judge Fletcher and which we adopt with minor modifications. Here we summarize only the most important steps. Mesabi Iron Company was incorporated in 1919 to mine iron ore in the Mesabi Iron Range in northern Minnesota. In consideration for the issuance of its stock, the company acquired fee ownership of a 5,700 acre tract and a leasehold interest in two other areas, one of 720 acres (Cloquet lease), and the other of 9,000 acres (Peters lease). Although Mesabi attempted to mine the leaseholds, the iron was a low grade ore called taconite and needed concentration in order to become commercially useful. Mesabi was unable to concentrate the ore on a profitable basis and suspended all mining operations in 1924.

By 1939, Mesabi was in debt by approximately $258,000 with few liquid assets. To pay its debts, but at the same time to retain the possibility of future profits from mining operations, Mesabi agreed with Reserve Mining Company, a newly formed corporation the stockholders of which were four iron and steel corporations, to lease to Reserve the lands which Mesabi owned and to assign to that firm the two leasehold interests. In return, Reserve took over Mesabi's debts and agreed, among other things, to pay Mesabi one-third of the net profits obtained from the lands, and to "endeavor to procure the highest current price known for material of like value in use and for like quantities" in making sales and determining profits. The parties set up a two-man board of arbitration to settle disputes, with a third arbitrator to be appointed if the first two disagreed.

Between 1942 and 1944, Reserve purchased through negotiation and on the open market, but with the help of Raymond B. Hindle, a stock broker who was also a director of Mesabi, 148,700 shares of Mesabi stock, or approximately 12% of the outsatnding total. Starting in 1951, Reserve began to develop its Mesabi leaseholds, having devised a commercially feasible way of concentrating the taconite. This development required capital expenditures of approximately $178 million which was financed in part by Reserve's stockholders and in part by borrowing. By 1956, Reserve began producing taconite pellets, an extremely useful form of iron ore, the entire production of which was sold under a 1953 agreement to the two companies which by then had sole and equal interests in Reserve—Republic Steel Corporation and Armco Steel Corporation.

From 1953 on, Reserve issued annual reports to Mesabi in which the former stated its net profits for the year and calculated Mesabi's share. Mesabi refused to accept each of these reports, contending that the sale price of the taconite was too low in that it did not take into account the efficiencies obtained by using the uniform, concentrated pellet, that some charges by Reserve for such items as hauling the taconite on Reserve's private railroad from the mine near Babbit to the production facilities at Silver Bay were too high, and that various other charges, such as losses on in-town real estate sales in Silver Bay, should not have been assessed at all. In addition, Reserve wished to offset immediately Mesabi's part of pre-production losses against Mesabi's profit share, while Mesabi wanted to amortize these losses over a number of years.

The preproduction loss issue was settled in 1956 with an agreement to amortize the pre-1956 losses over a 13-year

period, one-third falling on Mesabi and two-thirds on Reserve. The other questions were still outstanding before either a two- or a three-man board of arbitration in February 1960.

During the late 1950's, the differences between Mesabi and Reserve came to a head in litigation. In 1957, several Mesabi shareholders filed a derivative action against Reserve and the then Mesabi board of directors, complaining about the failure of Mesabi to effectively prosecute its claims against Reserve. The complaint stated that Reserve was indebted to Mesabi for 1956 profits in the amount of $8,000,000. The Delaware court in which the suit was brought sequestered Reserve's stock holdings in Mesabi. In 1958, a dissident group of stockholders won a proxy fight against the old Mesabi management (Reserve voting its shares for the losing side). New management informed Mesabi shareholders that the arbitration would not lead to an acceptable agreement with Reserve in a reasonable period of time, and that Mesabi would now attempt to settle the differences in court. Reserve then filed an action in a Minnesota state court (removed at Mesabi's request to federal district court) to force Mesabi to live up to its agreement to arbitrate. Mesabi countered with counterclaims against Reserve and its stockholders, Armco and Republic, for antitrust violations in the distribution and pricing of taconite and for conspiring to interfere with the lease agreements. Mesabi also brought an antitrust action on a similar basis against Armco and Republic in the federal district court in Delaware and another suit in a Delaware state court against Reserve and Raymond Hindle, alleging a diversion of corporate opportunity in Reserve's 1940's purchases of Mesabi stock and requesting return of the stock. The new management also took over the position of the plaintiff stockholders in the Delaware derivative action. None of these cases was settled or completed prior to February 1960.

The alleged dollar values of the suits, according to the complaints, were:

(1) $8,000,000 lost profits for 1956 in the derivative suit

(2) $16,166,667 lost profits for 1956 and 1957 in the Minnesota counterclaim

(3) $12,500,000 trebled ($37,500,000) for antitrust violations in the Minnesota counterclaim

(4) $22,500,000 trebled ($67,500,000) for antitrust violations in the Delaware federal suit

In addition, the Delaware state suit requested the return of 147,700 shares of Mesabi stock,[1] and Mesabi continued to pursue lost profit claims for 1958 and 1959 out of court. While the amounts listed above obviously overlap in some respects and are undoubtedly exaggerated, they do provide some idea of the magnitude of the claims Mesabi had outstanding against Reserve and its shareholders as of February 1960.[2]

By January 1960, the three-man board of arbitration had completed hearings on all questions except that of the propriety of Reserve's pricing of taconite pellets in its sales to its owners, Armco and Republic. On January 21, 1960, the independent arbitrator ruled that Reserve should turn over to Mesabi its records dealing with the price of taconite pellets in sales to Republic and Armco. The hearings were adjourned until March 1960.

[1] The number of shares held by Reserve was increased to 163,570 as a result of a 1959 "stock dividend." It was later discovered that Mesabi did not have sufficient surplus to issue a legal dividend, and the transaction was relabeled a "stock split" and so entered on Mesabi's books.

[2] Not included in the listing is the almost $10,000,000 lost-profits claim for the years 1956-1958 which Mesabi was pursuing in arbitration, *See* Finding of Fact 29.

Possibly because of this new development, the arbitration proceedings were never reconvened. Rather, Reserve initiated talks aimed at settlement of all disputes. Reserve's goal seems to have been to end all past, present, and future controversies over net profits by putting Mesabi's payments on a royalty-per-ton basis, a proposal Reserve had made several times since 1950. Mesabi was similarly anxious to get out of litigation on net profits, but only at a royalty substantially higher than that offered previously. Mesabi management was also very interested in acquiring Reserve's 12% of the outstanding Mesabi stock, in order to eliminate the threat that Reserve would vote its stock in its own interest rather than Mesabi's.

On February 18, 1960, the negotiators reached an agreement under which Mesabi would receive $400,000 and all of Reserve's stock in Mesabi (now 163,570 shares, *see* footnote 1, *supra*). Mesabi would drop all claims against Reserve, its shareholders, and Hindle, and the 1939 agreement would be modified to provide Mesabi with royalties of $1.00 per adjusted ton of taconite concentrate shipped. At Reserve's request, the agreement provided that it would not become effective until approved by a majority of Mesabi's outstanding shares but that the shares held by Reserve could not be voted nor counted toward the majority. The closing was to take place on the fifth business day following approval by Mesabi's shareholders.

On February 19, 1960, Reserve's directors and its two shareholders approved the agreement. Mesabi's directors met the same day and passed a series of approving resolutions. The only significant difference between the agreement and the resolutions was that while the former indicated that the stock and cash would both be exchanged for the pre-1960 profits claims and those claims only (not for the antitrust claims), the resolutions provided that the cash would be tied to the claims relating to pre-production losses, the profits claim, and the lease modification, that all

suits against Reserve would be dismissed by Mesabi with prejudice, and that Mesabi would receive Reserve's shares. The minutes of that meeting, and testimony taken at trial, indicate that Mesabi's directors were concerned whether the agreement was a fair exchange and also about its tax consequences, and the company's counsel, Mr. Lester Tanner, advised them on these matters.

While the minutes do not so show, Mr. Tanner testified that he had advised the board that the stock and cash together, using the closing price of the stock on the American Stock Exchange on February 18,—40⅜, were worth approximately $7,000,000 and that this amount was about all Mesabi could expect to obtain from its pending claims. Mr. Tanner also advised, according to this trial testimony, that Mesabi's tax liability from the settlement would be a maximum of $7,000,000 of ordinary income, but that it was possible that the exchange could be viewed as a tax-free redemption or an exchange of capital assets.[3]

On February 20, Mesabi issued a press release and shareholder's letter stating that a settlement had been reached, subject to shareholder approval, and briefly outlining the

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[3] While Mr. Tanner likewise testified that Mesabi was deeply concerned about the extent of its tax liability and would not have wanted a more lucrative settlement because the company was cash-poor, we hesitate to accept this observation since this concern is nowhere noted in the minutes of the meeting, and Mesabi paid its shareholders a cash dividend of $3.00 per share, or a total of $3,579,672, in November 1960—after the settlement and before the 1960 taxes were due. The dividend was, in fact, paid over the objection of plaintiff Haas that the cash would be needed for tax purposes. Furthermore, Mesabi floated an issue of 119,322 shares of stock at $60.00 a share in early 1961, which it evidently had no difficulty selling to its shareholders through a rights offering (the stock was priced on the market at approximately $120 when the rights were issued). The prospectus for the rights offering stated that the shares were being sold to create a cash reserve to pay taxes which might be due because of the settlement if the Mesabi shares received were valued at a price higher than 40⅜.

details of the agreement. The release and letter, although not the agreement itself, also stated that the shares received would not be reissued. The formal settlement agreement, which tracked the draft agreement rather than the resolutions and was dated February 19, 1960, was signed by Mesabi's president on February 28, and by Reserve's on March 2. Between February 18 and March 2, the closing price of Mesabi stock on the American Stock Exchange rose from 40⅜ to 60⅞. On March 21, 1960, Mesabi sent its stockholders a proxy statement (dated March 18) for the April 22 shareholder's meeting at which there would be a vote on the settlement agreement. The proxy statement did not attempt to put any value on the shares to be received from Reserve. It also did not indicate that the stock was to be received only in exchange for the royalty claims. On March 22 and 23, it was reported in the press that Mesabi was considering changing from corporate to trust form to avoid double taxation of its profits if the settlement agreement were approved. On April 7, Reserve announced its intention to expand production, which would, of course, increase Mesabi's royalties.

During this entire period, various brokerage houses were advising customers to buy Mesabi stock as a good income investment and also for possible capital gain. Presumably because of the settlement and related activities, trading in Mesabi stock increased substantially in volume from February 18 on. For example, 24,600 shares were traded in January, 145,100 in February, and 172,700 in March. In addition, the price began a lengthy and substantial climb from 40⅜ on February 18, 1960 to over 90 by the end of 1960. On April 21, the day before the Mesabi shareholders' meeting, the stock closed at 82¾, and the mean sales price on April 22 was 78¼.

At the April 22 shareholders' meeting, the agreement was approved by a vote of 1,016,049 shares to 970 shares, far in excess of the 661,898 shares needed to ratify. Ap-

proximately 87% of the shares eligible to vote were voted. By April 27, when the closing took place, all of Mesabi's litigation with Reserve, Republic and Armco had been terminated. Mesabi received Reserve's shares, the $400,000 provided by the settlement agreement, and $1,464,960.05 as a royalty payment for the first quarter of 1960. The shares were received free and clear of all claims, liens, or encumbrances, since the sequestration orders covering them had been lifted at Mesabi's request on April 25. The mean price for which Mesabi stock was selling on the American Stock Exchange on April 27 was 73¼.

In its 1960 income tax return, plaintiff acknowledged that it had received income through the settlement agreement, declaring the shares to have been worth $5,908,966.25 —163,570 shares at $40.375 each (the February 18, 1960 closing price on the American Stock Exchange) less a "blockage" discount of $4.25 per share. The Internal Revenue Service, on the other hand, took the position that the proper value of the stock was its value on April 22, 1960 (when the shareholders approved the settlement agreement), that that value is best evidenced by the mean trading price on the American Stock Exchange that day, *i.e.*, $78.25, and that plaintiff had not shown itself entitled to any blockage discount. Defendant therefore priced the stock at $12,799,352.50. The disputed tax is a result of this difference in valuation, with credits for increased state royalty taxes and for increased depletion deductions if the higher figure is taken into account.

The controversy in this court centers on whether (1) the value of the stock for tax purposes was its worth as of February 18, 1960, the date on which negotiators for Mesabi and Reserve reached their agreement, or April 22, 1960, the day on which the Mesabi shareholders gave their approval; and (2) if the April 22 date is chosen, the value of the stock on that date. Plaintiff contends that the value as of February 18, 1960 is the proper figure but that even if April 22 is the crucial date, the correct April 22 value

of the block of shares was no more than its February 18 value.[4]

II

Valuation Date

Plaintiff insists that this is not an "accounting" case, since there is no issue as to *when* the value of the shares was to be taken into income; Mesabi was on the accrual basis and taxpayer agrees that the taking-into-income date was April 22, 1960, when the Mesabi-Reserve agreement became final and binding through the vote of Mesabi's stockholders. But, says plaintiff, the evaluation date need not be the same as the taking-into-income date; in this instance it should be February 18, 1960, when the parties made their bargain and (it is said) fixed a firm value for the shares to be transferred.

Our difficulty with this approach is that it runs counter to the basic principle that under the federal income tax system items are taken into income at their then current value. The Code's provision for different accounting methods, and related regulations, do not directly tell us this but they do so by implication, and this has been the consistent course of judicial and administrative treatment under the income tax. *See* Treas. Reg. §§ 1.61-2(d)(4), 1.451-1(a), 1.161-2(d)(2)(i). It is this proposition which, for example, creates the need to undertake the difficult task of determining the present value of future interests. *See* Treas. Reg. § 1.1001-1(a); Rev. Rul. 58-402, 1958-2 C.B. 15; *Grill* v. *United States,* 157 Ct. Cl. 804, 809-11, 303 F. 2d 922, 925-26 (1962). *Compare Burnet* v. *Logan,* 283 U.S. 404 (1931) (rights to future receipts presently incapable of valuation need not be included in income until received).

[4] Plaintiff's petition originally claimed in the alternative that the shares were received in a tax-free redemption or in exchange for a capital asset. Both theories have been discarded by stipulation and are not before us.

When income is received, be it on the day the right to receive becomes fixed, as with an accrual basis taxpayer, or when beneficial ownership commences for a cash basis taxpayer, the amount of income received becomes set at its then value. *See Fordyce* v. *Helvering,* 76 F. 2d 431, 434-35 (C.A.D.C. 1935); *C. M. Hall Lamp Co.* v. *United States,* 201 F. 2d 465, 468 (C.A. 6, 1953); *Hoffer* v. *Comm'r,* 24 B.T.A. 22, 27 (1931). Parties cannot arbitrarily decide that they are dealing, for instance, in deflated 1933 dollars when cash is received. While an exchange of property is more complex in that the current value of the item received may not be self-evident, the same principle applies.

Plaintiff cites two recent cases which it claims support its point that an item, particularly stock, need not be taken into income at its value on the date on which it is includable in income. *White Farm Equipment Co.* v. *Commissioner of Internal Revenue,* 61 T.C. 189 (1973), *rev'd sub nom., Amerada Hess Corp.* v. *Comm'r.,* — F. 2d — (Nos. 74-1633, 74-1634, 74-1635) (C.A. 3, May 13, 1975),[5] while relevant on the subject of valuation, does not at all sustain taxpayer on the date of-valuation issue. In *White Farm,* the court clearly viewed the proper valuation date as October 31, 1960, the day on which shareholders of both companies approved the agreement, and felt called upon to determine the proper value of the stock received as of that date. 61 T.C. at 214-15; — F. 2d at — n. 29 (slip. op. at 15 n. 29). Whatever the correctness of the court's determination of the value as of October 31, 1960, that was plainly chosen as the valuation date.

The other case is *Herbert J. Investment Corp.* v. *United States,* 360 F. Supp. 825 (E.D. Wis. 1973), *aff'd per curiam,* 500 F. 2d 44 (C.A. 7, 1974), in which plaintiff trucking

[5] The Third Circuit decision in *White Farm,* which reaches a result similar to that we reach, issued subsequent to the preparation of this opinion. While that decision supports our reasoning, we have reached our conclusion independently.

company sold all its assets to a second company, CW Transport, Inc., in return for cash and stock in CW. The agreement, which was subject to approval by the I.C.C., provided that CW would take control of the assets and the assets would be appraised to set a firm sales price as soon as possible after temporary approval of the I.C.C. was received, but that title would not actually pass in either direction until the I.C.C. granted permanent authority. Following I.C.C. temporary approval on March 26, 1968, CW, on April 1, took over all plaintiff's assets and customers, and replaced all officers and all but one director. By agreement, all profits and losses of the business after April 1 were CW's, and plaintiff received interest on the purchase price—the value of the assets as of April 1—from that date until final settlement. ICC permanent approval followed, and the agreement was formally closed on August 30. The market price of CW stock had increased substantially between April 1 and August 30, and after plaintiff valued the shares as of the earlier date, the Service assessed a deficiency, claiming that the later time was proper for valuation. The District Court found that, while ICC approval was not a mere formality, it was so likely that everyone—the stock market, the industry, and most important the parties—treated the transfer as completed on April 1. In those circumstances, the court found that equity compelled a finding that the shares had been effectively transferred on April 1, and the value on that date should control.

The critical difference between *Herbert J. Investment* and the present case is that in the former the parties did not wait for final ICC approval to close the transaction but effectively closed it as of April 1st and deemed it permanent as of that time. As the District Court pointed out (360 F. Supp. at 827-28), the "consummation itself [after final ICC approval], however, was actually nothing more than formalization of the arrangement effected by the parties on April 1," and the parties "fully committed

themselves to the impact of their agreement on April 1, 1968, and treated the possible failure of final approval as a real, but highly unlikely, condition subsequent. * * * The time of transfer of dominion and control over assets which are the subject of a sale is a more important consideration than the time of ultimate payment or conveyance of formal title."

Here, on the other hand, no effort was made to close in any way before the vote of the Mesabi stockholders on April 22, nor was it ever contemplated that the actual closing could or would precede that event. The parties were very careful not to disturb the main bargaining counters each had—the lawsuits—until after shareholder aproval. The agreement's provision that closing would be delayed for five days after approval was related to this decision. No stock or money changed hands before April 22. Reserve's plans for expansion, though announced between the signing of the agreement and the Mesabi stockholders' meeting, stated that expansion would be undertaken "[*i*]*f* the settlement is made as contemplated, * * * " (emphasis added). The shareholders approval was treated throughout as a most significant condition precedent, not as a condition subsequent as in *Herbert J. Investment*. In short, while the present parties could have presented us with a case like that one, they have not.

We add that here stockholder approval, though probable, was surely not a mere formality. Mesabi stockholders had not been a docile group, as the 1958 proxy fight showed, and major blocks of shares were still in the hands of persons associated with old managment. Furthermore, Mesabi had, on the record date for the vote, over 2700 individual and 250 institutional shareholders. Most of the shareholders had fewer than 100 shares, and no individual shareholder owned more than 37,154 shares directly. Since Mesabi had agreed to an absolute majority vote, non-voting shares were in effect voted against the agreement. While Mesabi's board of directors might have

been convinced that those who voted would vote for the agreement, the failure, through disinterest or inadvertence, of small shareholders to vote could have prevented ratification and must be considered a risk to final approval of the agreement. In fact, the agreement received the vote of only 87% of the eligible shares, not the 99.9% plaintiff claimed.

Plaintiff has argued that acceptance of the accrual date as the valuation date leaves the parties unable to determine in advance the tax consequences of a transaction in which actively traded stock is exchanged. The point fails to recognize that the participants could agree on a purchase price and provide that it would be paid in "x" shares of stock at the market price on the final date of agreement plus or minus a cash balancer. There is no reason to believe that this formula was considered and rejected in this instance as infeasible. As the evidence and particularly the testimony of Mr. Jesse Climenko, plaintiff's counsel at the time, shows, Mesabi was not particularly interested in how many dollars it was receiving (beyond a certain minimal amount) but in ending Reserve's interest in Mesabi and in modifying the lease agreement. (Climenko, Tr. at 109-110.) Plaintiff, while it had concern for the tax consequences, had other thoughts uppermost in its corporate mind in February 1960, and should not be heard now to complain that, if it had wanted to, it could not effectively have arranged the transaction so as to predetermine the tax consequences.

Nor is it an adequate answer to say that the Treasury would not be harmed by allowing the parties to fix the value of transferred property at a time prior to and lower than the date-of-taking-into-income since a decrease in one side's tax (as here)[6] would be counterbalanced by an equivalent increase in the tax owed by the other side. That is not always true even if the Service manages to

[6] If the value of the property had increased by the time of taking into income.

keep both taxpayers before it at the same time; the theoretical increase in tax for the one party may be washed out, in actual fact, by its own special circumstances. And in any event it would be a considerable administrative burden on the Service to ensure that in all such instances it kept the cases of the two (or several) taxpayers always in tandem so as to be able to collect, on balance, a tax based on the property's value at the date-of-taking-into-income. The general rule is that while the parties may be normally bound by the value agreed upon between them, the Service is not so restricted. *Commissioner* v. *Danielson*, 378 F.2d 771, 774-75 (C.A. 3), *cert. denied,* 389 U.S. 858 (1967); *see Eckstein* v. *United States*, 196 Ct. Cl. 644, 655, 452 F. 2d 1036, 1042 (1971).

III

Value as of April 22, 1960

Our decision that the stock received must be valued at its April 22, 1960 value does not decide what that value was. The starting place for discussions of value is of course the proposition that the "fair market value is the price at which property would change hands in a transaction between a willing buyer and a willing seller, neither being under compulsion to buy or sell, and both being reasonably informed as to all relevant facts." *Jack Daniel Distillery* v. *United States*, 180 Ct Cl. 308, 315-16, 379 F.2d 569, 574 (1967). Where stock is freely traded in an open, organized market, stock exchange quotations for the valuation date generally provide the best evidence of value.[7] *See Moore-McCormack Lines, Inc.* v. *Comm'r*, 44 T.C. 745, 759 (1965);

[7] Plaintiff has not questioned defendant's use of the mean between the high and low price at which the shares traded on April 22 as a valid measure of the stock market price on that date, even though the calculation is found in the estate, rather than income tax, regulations. Treas. Reg. § 20.2031-2(b). Defendant's practice has been accepted as valid by the Tax Court in income tax proceedings, and, in the absence of any complaint by plaintiff, we are inclined to follow. *See Meyer* v. *Comm'r*, 46 T.C. 65, 106 (1966), *modified on other grounds*, 383 F.2d 883 (C.A. 8, 1967).

Southern Natural Gas Co. v. *United States,* 188 Ct. Cl. 302, 351-52, 412 F.2d 1222, 1252 (1969); 10 J. Mertens, The Law of Federal Income Taxation §§ 59.13 at 42-43, 59.14 at 47 (1970). However, extraordinary circumstances relating either to the state of the market or to the shares actually being valued can make market quotations unreliable indicators of true value. *Taylor* v. *United States,* 33 AFTR 2d 74-1317, 1320 (E.D.N.C. 1974). Several possible factors have been discussed in this regard and plaintiff has, at various points in the proceeding suggested that some may be applicable.

a. Primarily, plaintiff says that the shares should be valued by the "barter-equation method" in which the value of an item received in an arm-length transaction is taken as equal to the value of the item given up. Under this theory the value which intelligent, knowledgeable parties with adverse interests put on an item should be regarded as the fair market value of that item, given the circumstances of the trade, since there usually is no other trade available for comparison which is identical in all respects. While the thought has some appeal, in all the cases we have been able to find in which it was used, the objective market price suffered from some deficiency not present here. *See, e.g., Moore-McCormack Lines, supra* (market too "thin" to absorb shares; shares carried "a bundle of collateral rights"); *Southern Natural Gas, supra* (no recent sales of closely held stock). In the present instance, there is no comparable reason for rejecting the active trading price on the exchange on April 22; if Plaintiff had chosen to reissue the shares at that time it would have gotten that price (as we show *infra*).

We also find that plaintiff's position suffers from the fatal flaw that there was no clear agreement between the parties on the value of what was being exchanged. *See KFOX Inc.* v. *United Staes,* 206 Ct. Cl. ——, 510 F.2d 1365, 1370-71 (1975); *Bar L Ranch Inc.* v. *Phinney,* 426 F. 2d 995,

1001 (C.A. 5, 1970). Unlike *Southern Natural Gas* and *Moore-McCormack, supra,* no value for the stock or for the items (release of claims) given in return was stated in the agreement. Nor did the agreement on its face tie the value of the shares to the then stock exchange price. There is absolutely no evidence in the record about what Reserve thought was the value of what it was receiving. There is no indication in the minutes of the February 19 Mesabi director's meeting (although there is in Mr. Tanner's notes prepared for that meeting) that there was discussion of the $7,000,000 figure for the total value received. Similarly, the proxy statement is silent in this regard. And the validity of the $7,000,000 figure is certainly open to question in light of the fact that it includes only the pre-1960 royalty claims while, no matter how the agreement was in fact drafted, Mesabi was actually giving up its right to pursue its antitrust cases, and its claims for the premium value of the taconite pelle claims which together exceed $50,000,000. In addition, Mesabi received more than stock and money—it received the right to definite and certain royalty payments in a clearly determinable amount—a right which it had not had before and which was, in fact, a major objective of the bargain.

Even if plaintiff were to overcome this significant hurdle of lack of a clear agrement on value, the "barter-equation method" should not be used. As the Second Circuit noted in a similar case, that method

> is a means which should be used only under certain limited conditions. The authority for it comes almost exclusively from cases involving valuation of property for which there is little or no market; * * * There are obvious dangers in evaluating the consideration involved in one side of a barter by determining the worth of the consideration on the other side. In the first place, the two sides of the barter may, for various reasons, not be equal in value. Secondly, the barter-equation method is in the nature of a bootstrap operation since there is usually no logical reason to start

> with one side rather than the other. * * * Thirdly, the evidence on the value of one side of a barter may be no more reliable than that on the value of the other side.

Seas Shipping Co. v. *Comm'r*, 371 F.2d 528, 529-30 (C.A. 2), *cert. denied*, 387 U.S. 943 (1967). All the problems highlighted by that court are present here.

First, there is the distinct possibility that the two sides of the barter were not equal in monetary value. According to the testimony of Mr. Climenko, Mesabi was most interested in two things: getting rid of Reserve's power over Mesabi by eliminating Reserve's stock ownership, and revising the lease agreement to give Mesabi an easily determinable royalty. The number of shares which Mesabi wanted to receive from Reserve was clear—all of them. What value each share had was, while not irrelevant, relatively unimportant, as was the total value. As one commentator has noted, "[W]hen shares are repurchased by a corporation from a dissenting stockholder, perhaps to get rid of him at any price [, the] stockholder might have been paid far more than his stock was worth, part of the payment actually representing nuisance value." Holzman, *When actual sales may not establish fair market value for securities*, 29 J. Tax 134, 135 (1968). Here, as there, the important objective was to seperate the other side from the shares, not to get a price equivalent to the things given up by Mesabi.

Second, plaintiff has not supplied us with a good reason why we should value the stock by the claims rather than the other way around. This is not a situation where an independant appraisal of the value of the claims was available, so that doubts about the wisdom of using April 22 market quotations as the value of the stock could be resolved by reference to an independent estimate of the value of what Mesabi was giving up. And third, the value of what was exchanged for the stock here is, if anything, even more speculative than the value of the stock. In addition to the problem of determining exactly what was given up, plaintiff has produced testimony on the speculative nature of some of its claims, and has shown that even the value of the pre-1960 profit share claims is difficult to determine. There is, for example, no congent evidence in the record of the exact value of the 1959 claim—all we know is that Reserve thought Mesabi entitled to $661,469 and that Mesabi thought "maybe we would have gotten $1,500,000, somewhere in that area" (Tanner, Tr. at 51). In the major case on the subject, *United States* v. *Davis*, 370 U.S. 65 (1962), the Court made no attempt to even try to determine directly the value of what the taxpayer had received (release of marital rights), but evaluated those rights by reference to the more easily ascertained value of the stock the plaintiff had given up. We think a similar solution is applicable here.

B. Restricted stock will frequently have a lower value than that traded on the exchange since it is by definition less marketable (*see, e.g., Heiner* v. *Crosby*, 24 F. 2d 191, 193 (C.A. 3, 1928)), but there is no ground for reducing the value of the shares at issue simply because they were originally subject to the Delaware sequestration orders. The settlement agreement provided that the actions under which the shares were sequestered would be dismissed "at or prior to closing" and the sequestration order in the *Mesabi* v. *Reserve and Hindle* case (the only order in evidence) provided that upon dismissal of the action the shares would be released from sequestration. Furthermore, that same order provided that, on Reserve's direction, the stock could at any time be sold upon provision of equal security Presumably, this provision would include a sale to Mesabi. In any event, the shares received were released from sequestration on April 25 and were received free and clear. Since the likelihood of the shares being obtained by Mesabi in restricted status was, by the terms of the settlement agreement, extremely small, we conclude that no deduction in the market price should be made on this account.

c. A corollary of the point just discussed is plaintiff's claim that these shares should be valued at a price other than the April 22d market price because they were not to be resold. But taxpayer had not entered into any binding agreement with anyone, including Reserve, to that effect. The cases cited are distinguishable in that there the parties exchanging the shares had agreed that the stock would not be resold or could be resold only under restrictive conditions. *See White Farm Equipment Co., supra,* 61 T.C. at 201-02 (stock to be distributed to recipient's shareholders or sold in a public offering with no order for more than 10,000 shares filled); *Seas Shipping Co.* v. *Comm'r,* 24 CCH Tax Ct. Memo 1222, 1226 (1965), *aff'd,* 371 F.2d 528 (C.A. 2, 1967), *cert. denied,* 387 US 943 (1967) (shares to be held for investment and not resold) Moreover plaintiff's action in early 1961 of floating a stock issue almost as large as the number of shares received from Reserve suggests that the plan to retire the shares permanently was not, in fact, fully realized

d. Another point is that the market prices either should be discarded completely or discounted because they are not reflective of the price at which the extremely large block of stock involved here would have sold, a phenomenon known as "blockage." *See Treas. Reg.* §20.2031-2(e). We note first that plaintiff has not objected to the trial judge's refusal, by implication, to find it entitled to a blockage discount. Our own analysis leads us to the same conclusion. While a large block of shares dumped on the market at one moment will ordinarily depress the market price for a time, *Seas Shipping Co.* v. *Comm'r, supra* 371 F.2d at 530, the courts which have considered the blockage issue have concluded that the problem should be treated in terms of whether the market could have absorbed the shares within a reasonable period of time. *Richardson* v. *Comm'r,* 151 F.2d 102 (C.A. 2, 1945), *cert. denied,* 326 U.S. 796 (1946); *White Farm Equipment Co., supra,* 61 T.C. at 215. In those cases in which either a blockage discount has been

allowed or the market price disregarded entirely because too large a block was involved, the number of shares being valued was very much greater than the total shares traded in a year. *See, e.g., Amerada Hess Corp., supra,* — F.2d at —, — (slip op. at 24-25, 28-29) (665,000 shares being valued; 444,000 traded during entire year); *Moore-McCormack Lines, Inc., supra,* 44 T.C. at 760 (300,000 shares being valued; 166,000 traded during entire year). In the present case, the record shows that the number of shares to be valued is smaller than that traded during the single month of March 1960. In the absence of any evidence from plaintiff to the contrary, we conclude that with this type of active market the shares could have been absorbed fast enough for a blockage discount to be inapplicable, and that the number of shares involved is not so large as to make the market prices inherently suspect.[8]

e. Plaintiff's final argument is one initially broached from the bench at oral argument on the earlier cross-motions for partial summary judgment. It was suggested then that, on analogy to condemnation cases, if plaintiff could prove that the increase in the value of the shares was a result of the settlement agreement, the fair market value for tax purposes might be considered the "pre-action" value, the worth as of February 18. Further reflection, aided by the presentations of the parties, has convinced us that the analogy is inapposite.

The Supreme Court has stated that in determining the amount due the owner of condemned property under the just compensation clause, "[it] is not fair that the govern-

[8] While defendant did not assess the shares at a value exceeding the market price, the fact that the block had substantial nuisance value and might in fact have been controlling if Reserve had pressed its position, tends to indicate that the shares might have had a premium rather than a depressed value. *See* 10 J. Mertens, The Law of Federal Income Taxation § 59.15 at 53 (1970); Treas. Reg. § 20.2031-2(e).

ment be required to pay the enhanced price which its demand alone had created. That enhancement reflects elements of the value that was created by the urgency of its need for the article. It does not reflect what 'a willing buyer would pay in cash to a willing seller,' in a fair market. * * * [T]he enhanced value reflects speculation as to what the government can be compelled to pay. * * * That is a value which the government itself created and hence in fairness should not be required to pay [citations omitted]." *United States* v. *Cors,* 337 U.S. 325, 333-34 (1949); *see United States* v. *Miller,* 317 U.S. 369, 375 (1943).

This rule excluding such "enhancement" has been limited, so far as we are aware, to condemnation cases, and there are several reasons why it should not be extended in plaintiff's favor. First of all, if the value of the shares was enhanced here because of the settlement agreement, that was due to the actions of both Mesabi (buyer) and Reserve (seller), and not that of the buyer alone; the increase was not attributable, as in the condemnation cases, to the buyer's special need for the property which itself pushed the price upwards. Second, it has not been proven what part of the increase was due to the settlement agreement and what part to Reserve's collateral but separate plan to increase production and to Mesabi's changeover from the corporate to the trust form. Third, Mesabi could, as we have discussed above, have resold the stock at its enhanced value and reaped the benefits of the enhancement. In a condemnation proceeding, on the other hand, the assumption is that, but for the condemnor's desire to acquire, the property could not have fetched the premium value claimed for it. If it were not for the "enhancement-exclusion" rule, the public authority would have to pay an extra sum, attributable to its announced need, which it would be unlikely to recoup or obtain any value for. The principle is one of fairness to the condemnor and at the same time to the condemnee. Finally,

we note that Mesabi was the recipient of the higher-value shares without being required to pay more than had been agreed on February 19, 1960, for those shares. This is the result the non-enhancement principle yields in the condemnation cases, and there is no need to tack on extra benefits to the buyer by taxing him at the lower value though he received and could take advantage of the higher.

Our conclusion, then, is that plaintiff has not produced any adequate reasons why we should disturb the defendant's determination that the traditional basis for valuation of widely-held stock should be used. We hold that the value of the stock Mesabi received was, on April 22, 1960, the mean of the high and low prices at which the stock was sold on the American Stock Exchange on that day, $78¼.

The taxpayer is not entitled to recover and the petition is dismissed.

Kashiwa, *Judge,* dissenting:

I respectfully dissent from the majority for the reasons hereinafter stated.

26 U.S.C. § 1001(b) (1970) provides, as pertinent herein, that the "amount realized from the sale or other disposition of property shall be the sum of any money received plus the *fair market value of the property* (other than money) received." [Emphasis supplied.] Under this basic section, the present case turns out to be a simple stock valuation case. There is no dispute in this case as to when income was to be reported so we are not concerned with the date on which all the events had occurred which would require Mesabi to accrue the value of the stock as income.[1] Our sole concern is the "market value" of the stock.

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[1] Treas. Reg. § 1.451-1(a) (1960) which states in pertinent part:
" * * * Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can

In *Jack Daniel Distillery* v. *United States,* 180 Ct. Cl. 308, 315-316, 379 F.2d 569, 574 (1967), we stated that:

> * * * The legal definition of fair market value is the price at which property would change hands in a transaction between a willing buyer and a willing seller, neither being under compulsion to buy or sell, and both being reasonably informed as to all relevant facts. *Wood* v. *United States,* 89 Ct. Cl. 442, 29 F. Supp. 853 (1939). [Footnote omitted.]

This definition is identical to that in *United States* v. *Cartwright,* 411 U.S. 546, 551 (1973). See. also, *White Farm Equipment Co.* v. *Commissioner,* No. 74-1635 (3rd Cir., May 13, 1975),[2] *rev'g,* 61 T.C. 189 (1973), where the same *Cartwright* decision of the Supreme Court is referred to and the decision of the Third Circuit is based on this fundamental principle.

The majority properly finds in its opinion portion of the decision (as distinguished from the findings of fact) that plaintiff and Reserve entered into an agreement:

> On February 18, 1960, the negotiators reached an agreement under which Mesabi would receive $400,000 and all of Reserve's stock in Mesabi (now 163,570 shares, *see* footnote 1, *supra*). Mesabi would drop all claims against Reserve, its shareholders, and Hindle, and the 1939 agreement would be modified to provide Mesabi with royalties of $1.00 per adjusted ton of taconite concentrate shipped. As Reserve's request, the

be determined with reasonable accuracy. * * *" This regulation is issued under Int. Rev. Code of 1954, § 451 entitled "General Rule for Taxable Year of Inclusion." Th focus under § 451 is only upon when income is to be reported. Section 451 is simply an accounting standard used to determine the year in which income is to be reported. The majority seems more concerned with this accounting standard than with what 26 U.S.C. § 1001(b) (1970) above quoted basically provides.

[2] Consolidated with *Amerada Hess Corp.* v. *Commissioner,* No. 74-1633 and No. 74-1634.

> agreement provided that it would not become effective until approved by a majority of Mesabi's outstanding shares but that the shares held by Reserve could not be voted nor counted toward the majority. The closing was to take place on the fifth business day following approval by Mesabi's shareholders.

It is important to note the majority also found specifically in its findings-of-fact portion of the decision that a price of $40 3/8 per share was "considered by the taxpayers' board of directors at their February 19, 1960 meeting" (Findings ¶ 52) when they considered and approved the settlement (Findings ¶¶ 32, 35). The majority further found that at that meeting the board of directors was advised by counsel "that $7,000,000 was the maximum amount that reasonably could be expected for [Mesabi's] pre-1960 claims" (Findings ¶ 35) and that in satisfaction of those claims Mesabi was receiving $400,000 cash plus Mesabi stock worth $6,600,000 being the 163,570 shares of Mesabi stock at $40 3/8 per share, thereby realizing what was essentially a complete victory with respect to its pre-1960 net profits claims (Findings ¶ 35). These findings are recited here because the majority after making these findings should not overlook the rest of the record in this case.

An examination of the entire record in this case shows that the evidence is clear, compelling, conclusive, and uncontradicted that the 163,570 Mesabi shares were valued on a $40 per share basis. There are 142 pages of uncontradicted testimony by witnesses Lester J. Tanner and Jesse Climenko in the record which clearly prove this. Furthermore, the fact that $40 was used as the per share value is supported not only by parol evidence but by documentary evidence received in evidence at the trial, plaintiff's Exhibit B. Added thereto, witness Lester J. Tanner explained in connection with Exhibit 58 the $7,000,000 settlement figure. Up until 1956 Reserve incurred operating losses which it claimed to be $18,421,844.23. Mesabi claimed they were $15,314,582.19. The losses had to be recovered from

profits before Mesabi could get its one-third share. An agreement was made whereby the losses would be amortized over a 13-year period so that if every year there were profits over and above one-thirteenth of the pre-production losses, Mesabi would get royalties. An amortization of \$15,314,582.19 at one-thirteenth a year for 1956, 1957, and 1958 would leave \$11,780,447.85 in unamortized losses. Therefore, one-third would have to be deducted from the balance due Mesabi: \$9,808,542.70 — \$3,926,815.95 = \$5,881,726.75. To this, add the claim for 1959 of approximately \$1,500,000, resulting in a total of \$7,381,726.75. This conclusively shows that \$7,000,000 was the settlement figure based on concrete figures.

In view of the clear record in this case above pointed out, it is difficult to depart from the conclusion that the parties intended the transaction to be \$400,000 plus 163,570 shares a \$40⅜ for claims worth about \$7,000,000. The arithmetic below cannot be denied:

163,570 shares at \$40⅜	=\$6,604,137.75
Cash paid	= 400,000.00
	\$7,004,138.75

This arithmetic is not a pure coincidence because \$40⅜ was the market price of Mesabi shares on February 19. Where the evidence is undisputed and the results are supported by plain arithmetic, there was only one conclusion the majority could have reached—the agreement and bargain of the parties necessarily included the value of \$40⅜ per share.

Under any written contract, consideration if not recited in the contract may be proven by parol evidence. *Bernatschke* v. *United States,* 176 Ct. Cl. 1234, 1239-40, 364 F.2d 400, 404-405 (1966); *Paccon, Inc.* v. *United States,* 185 Ct. Cl. 24, note 11, 399 F.2d 162, note 11 (1968). Although the value of the 163,570 Mesabi shares was not recited, it was proven by parol evidence. The trial judge allowed 147 pages

of testimony to prove that the shares were valued at \$40 per share, the February 19 value. Documentary evidence was also allowed to fully corroborate the parol proof. Such proof uncontradicted is equivalent to a full recital of the consideration in the contract.

In tax cases where parties to a contract agree to a price, courts will let the contract price stand. This is a rule of much significance because the Supreme Court in *United States* v. *Davis,* 370 U.S. 65 (1962), used the above-mentioned rule to partially reverse a prior opinion of this Court, *Davis* v. *United States,* 152 Ct. Cl. 805, 287 F.2d 168 (1961). The Court stated at 72-73:

> It must be assumed, we think, that the parties acted at arm's length and that they judged the marital rights to be equal in value to the property for which they were exchanged. *There was no evidence to the contrary here.* Absent a readily ascertainable value it is accepted practice where property is exchanged to hold, as did the Court of Claims in *Philadelphia Park Amusement Co.* v. *United States,* 130 Ct. Cl. 166, 172, 126 F. Supp. 184, 189 (1954), that the values "of the two properties exchanged in an arms-length transaction are either equal in fact, or are presumed to be equal." Accord, *United States* v. *General Shoe Corp.,* 282 F.2d 9 (C. A. 6th Cir. 1960); *International Freighting Corp.* v. *Commissioner,* 135 F.2d 310 (C. A. 2d Cir. 1943). To be sure there is much to be said of the argument that such an assumption is weakened by the emotion, tension and practical necessities involved in divorce negotiations and the property settlements arising therefrom. However, once it is recognized that the transfer was a taxable event, it is more consistent with the general purpose and scheme of the taxing statutes to make a rough approximation of the gain realized thereby than to ignore altogether its tax consequences. Cf. *Helvering* v. *Safe Deposit & Trust Co.,* 316 U.S. 56, 67 (1942). [Emphasis supplied.]

The rule has since been followed by this court. See *Davee* v. *United States,* 195 Ct. Cl. 184, 444 F.2d 557 (1971); *Republic*

Steel Corp. v. *United States,* 94 Ct. Cl. 476, 40 F. Supp. 1017 (1941); *Annabelle Candy Co.* v. *Commissioner,* 314 F.2d 1 (9th Cir. 1962); *Ullman* v. *Commissioner,* 264 F.2d 305 (2d Cir. 1959). And more recently, this court stated in *KFOX, Inc.* v. *United States,* No. 151-71 (Ct. Cl., February 19, 1975), at page 8 of the slip opinion:

> When two parties to the sale of assets explicitly allocate the aggregate purchase price to the various assets being sold, the valuation they put on each asset will usually be accepted for tax purposes so long as the parties have opposing tax positions and have acted *without collusion or fraud and the allocation is not so disproportionate as to be unreasonable.* *Davee* v. *United States,* 195 Ct. Cl. 184, 444 F.2d 557 (1971); *Republic Steel Corp* v. *United States,* 94 Ct. Cl. 476, 40 F. Supp. 1017 (1941); *Annabelle Candy Co.* v. *Commissioner,* 314 F.2d 1 (9th Cir. 1962); *Ullman* v. *Commissioner,* 264 F.2d 305 (2d Cir. 1959). To the extent, therefore, that the parties agreed to allocate and in fact did allocate the aggregate price over all of the assets we would be constrained to follow that allocation as the basis to be applied in depreciating those assets. * * * [Emphasis supplied.]

There is no finding of collusion or fraud by the majority. The exchange quotation of Mesabi shares was at $40⅜ on February 19 as there is nothing disproportionate in using a $40 figure.

The majority's reason for departing from the $7,000,000 agreement is the following:

> * * * And the validity of the $7,000,000 figure is certainly open to question in light of the fact that it includes only the pre-1960 royalty claims while, no matter how the agreement was in fact drafted, Mesabi was actually giving up its right to pursue its anti-trust cases, and its claims for the premium value of the taconite pellets. claims which together exceeded $50,-000,000. In addition, Mesabi received more than stock and money—it received the right to definite and certain royalty payments in a clearly determinable amount—a right which it had not had before and which was, in fact, the major objective of the bargain.

The $7,000,000 figure is not open to question because it was agreed upon by the parties and since there is no fraud or collusion, it should not be disturbed. As for Mesabi rights to receive royalty payments for the iron ore, the prior lease agreement provided for a percentage-of-profit type of payment. The new agreement provided for a fixed amount per ton. It was a mere substitution of one method of computation over another. The majority opinion sounds as if an entirely new source of income was provided. This was not so. The antitrust claims were valued at zero at the request and insistence of Reserve (Tr. 129-130). The parties so decided and we should not engage in the revaluation of anti-trust claims, a task most difficult and extremely speculative.

The majority treats the shareholder approval in this case as a condition precedent. I quote:

> * * * The shareholders' approval was treated throughout as a most significant condition precedent, not as a condition subsequent as in *Herbert J. Investment.* In short, while the present parties could have presented us with a case like that one, they have not.

The majority evidently missed a material point in the transcript. Under the laws of the State of Delaware, where Mesabi was incorporated, it was not necessary to obtain shareholder approval of the February 19 settlement agreement. The board of directors of Mesabi had the authority to enter into the agreement without shareholder approval (Tr. 71-72). The provision as to Mesabi shareholder approval was put in the settlement agreement only at the request of Reserve.

A careful reading of the agreement, therefore, shows that the parties entered into a binding agreement when they signed the agreement. But they were to be discharged of

their assumed obligations if the shareholders' approval did not take place. I incorporate the material portions of the agreement to show that a condition subsequent was intended.[3] The language of paragraph 9 of the agreement, which reads as follows:

> 9. The Closing shall be held on the fifth business day following the close of the meeting of Mesabi's stock-

[3] The material portions of the agreement of February 19, 1960, were as follows:

"1. Subject to the conditions hereof Mesabi and Reserve shall, at the Closing, execute and deliver an instrument in the form of Exhibit A hereto to amend the Assignment and an instrument in the form of Exhibit B hereto to amend the Mesabi Lease, * * *.

"2. Subject to the conditions hereof Reserve shall, at the closing, (a) pay to Mesabi $400,000, and (b) assign to Mesabi all of Reserve's right ,title and interest in all of the shares of common stock of Mesabi owned by Reserve (which Reserve represents total 163,570 shares). * * *.

"3. Subject to the conditions hereof, Mesabi and Reserve, at or prior to the Closing, shall cause the above-mentioned arbitration proceedings to be terminated.

"4. Subject to the conditions hereof, Mesabi and Reserve, at or prior to the Closing, shall (a) stipulate for the dismissal with prejudice of all pending actions or counterclaims of either of them against the other, its present and former officers, directors or stockholders, and (b) cause to be dismissed by stipulation of the necessary parties thereto, or move to dismiss, the above-mentioned *Putterman* v. *Daveler* action and take all steps reasonably necessary to secure a prompt dismissal of such action.

"5. Subject to the conditions hereof, effective at the Closing, each party hereby releases the other party, its present and former officers, directors and stockholders in whatever capacity, from all claims, demands, actions or causes of action of any kind or nature, * * *.

* * * *

"8. Performance of the obligations of Mesabi and Reserve set forth in paragraphs 1 through 5 above are subject to the conditions that approval and authorization shall have been given by the affirmative vote of the majority of all of the outstanding shares

> holders approving and authorizing the matters covered by this agreement as hereinbefore provided at the office of Republic, Republic Building, Cleveland, Ohio, or at, such other time and place as Mesabi and Reserve shall theretofore mutually agree. If the Closing is not held, this agreement shall become null and void and shall be without prejudice to Mesabi, Reserve, Armco and Republic, and their respective present and former officers, directors and stockholders.

clearly shows a present obligation to be discharged upon the nonoccurrence of the condition subsequent; to wit, disapproval by the shareholders.

Furthermore, as a part of the record in this case, Gilbert M. Haas, in Answer to Interrogatories,[4] filed December 30, 1970, stated as follows:

> Moreover, Reserve was not concerned about the outcome of a vote by the Mesabi shareholders. Mr. Arnold Hoffman and I were in constant communication with the principal shareholders of Mesabi, and as a result of our close contact with the shareholders we were able to assure the officers of Reserve, that the shareholders of Mesabi would overwhelmingly accept and approve the terms of a settlement Agreement recommended by the Mesabi Board of Directors. In fact, it was not

of Mesabi, excluding from such majority the shares owned by Reserve .

"9. The Closing shall be held on the fifth business day following the close of the meeting of Mesabi's stockholders approving and authorizing the matters covered by this agreement as hereinbefore provided at the office of Republic, Republic Building, Cleveland, Ohio, or at such other time and place as Mesabi and Reserve shall theretofore mutually agree. If the Closing is not held, this agreement shall become null and void and shall be without prejudice to Mesabi, Reserve, Armco and Republic, and their respective present and former officers, directors and stockholders."

[4] Made part of the record by Plaintiff's Motion for Partial Summary Judgment, filed October 20, 1971. See, also, pages 7 to 11 of the uncontradicted Affidavit of Gilbert M. Haas, attached to said motion as an exhibit. See Rule SS(a) of this court.

until after I personally assured Mr. William Bryant, an officer of Reserve, in December 1959 that it was an absolute certainty that the shareholders of Mesabi would accept and approve the terms of any settlement recommended by the Mesabi Board of Directors, that negotiations for settlement were initiated and seriously pursued by Reserve. [At p. 3.]

* * * * *

While I am unable to recall with particularity the names and holdings of many of the other stockholders who were contacted during the period February 20, 1960, through March 4, 1960, I attempted to record in my diary many of the names of the Mesabi shareholders or representatives with whom I talked during this time period. I have attached copies of the pertinent diary pages. However, at this late date I an unable to recall the specific holdings of these individuals or representatives, nor am I able to relate many of the names with the owners of record contained in the list of stockholders being supplied by Bankers Trust Company, because the majority of the principal shareholders held their shares in "street name" and under various nominees. In any event, I do recall that all the people with whom I talked approved the terms of the Settlement Agreement and that their holdings, coupled with the holdings of Messrs. Joseph, Mudd, Fine, the individual directors of Mesabi and the Axe-Haughton Fund, represented more than two-thirds of Mesabi's total 1,323,794 outstanding shares, excluding the 163,570 shares owned by Reserve. * * * [At p. 7.]

The above answer by Gilbert M. Haas clearly shows that shareholder approval was only a technicality, just as much as the Interstate Commerce Commission's final approval was a technicality in *Herbert J. Investment Corp.* v. *United States*, 360 F. Supp. 825 (E.D. Wis. 1973), *aff'd per curiam*, 500 F. 2d 44 (7th Cir. 1974).

The agreement of February 19, 1960, was signed by Mesabi's authorized officer on February 28, 1960, and by Reserve's authorized officer on March 2, 1960. When the document was signed on the respective dates by Mesabi's

officer and Reserve's officer, they knew that shareholder approval was forthcoming and that shareholder approval was just a technicality. Gilbert M. Haas was elected a director of Mesabi in 1958 and he worked closely with Arnold Hoffman, president of Mesabi, in 1958, 1959, and 1960. The majority's following finding and conclusion regarding stockholder approval were in error:

> We add that here stockholder approval, though probable, was surely not a mere formality, Mesabi stockholders had not been a docile group, as the 1958 proxy fight showed, and major blocks of shares were still in the hands of persons associated with old management. Furthermore, Mesabi had, on the record date for the vote, over 2700 individual and 250 institutional shareholders. Most of the shareholders had fewer than 100 shares, and no individual shareholder owned more than 37,154 shares directly. Since Mesabi had agreed to an absolute majority vote, non-voting shares were in effect voted against the agreement. While Mesabi's board of directors might have been convinced that those who voted would vote for the agreement, *the failure, through disinterest or inadvertence, of small shareholders to vote could have prevented ratification and must be considered a risk to final approval of the agreement.* In fact, the agreement received the vote on only 87% of the eligible shares, not the 99.9% plaintiff has claimed. [Emphasis supplied.]

They are completely contrary to Gilbert M. Haas' statement. The majority's finding that "the failure, through disinterest or inadvertence, of small shareholders to vote could have prevented ratification and must be considered a risk to final approval of the agreement," the portion I have emphasized in the above quotation, is contrary to Mr. Haas' statement in the record. To substantiate Mr. Haas' statement, there is a reproduction of many pages from his memorandum book showing the names of shareholders he called.

In concluding, it is submitted that it is the record that counts and this dissent is based on the record.

FINDINGS OF FACT

The court having considered the evidence, the decision and findings of Trial Judge Lloyd Fletcher, and the briefs and arugments of counsel, makes findings of fact as follows:

1. The plaintiffs in this action are trustees under an agreement of Trust dated as of July 18, 1961, entered into under the laws of the State of New York by and between Mesabi Iron Company (hereinafter also referred to as taxpayer), party of the first part, and Bankers Trust Company, Arnold Hoffman, Arthur G. Logan, Gilbert M. Haas, and Earl Knudsen, as trustees, parties of the second part. Upon the deaths of Arnold Hoffman and Arthur G. Logan, Francis D. Butler and Norman F. Sprague, Jr. became trustees. The Agreement of Trust provides that the trust established thereby may be known as the "Mesabi Trust."

The facts of the case have been largely stipulated. Also, they have been in part recited by the court in its opinion dated May 12, 1972, dealing with cross-motions for partial summary judgment, in which opinion the court returned the case to the commissioner for trial and a fuller development of the relevant facts. *Bankers Trust Co., et al.* v. *United States*, 198 Ct. Cl. 306, 459 F. 2d 484 (1972).

2. The Mesabi Iron Company was incorporated under the laws of the State of Delaware in December 1919. At the time of its incorporation, taxpayer acquired, in consideration for the issuance of its stock, fee ownership of a 5,700-acre tract of land (hereinafter referred to as the "Mesabi Lease Land") in the Mesabi Iron Range in northern Minnesota, and a leasehold interest in two tracts of land—one of 720 acres (hereinafter referred to as the "Cloquet lease"), and the other of 9,000 acres (hereinafter referred to as the "Peters lease"), also located in the Mesabi Iron Range and containing extensive deposits of low grade iron ore. Mesabi also received an option to

purchase an interest in the Dunka-Mesaba Security Company, fee owner of the Peters lease. Mesabi partially exercised the option in 1921, and acquired a 20% stock interest in the company. By 1951, and continuing to the time of the Settlement Agreement, Mesabi held a 20% undivided interest in the Peters lease land. Royalties were paid to Mesabi on a per-ton basis as fee owner. Mesabi's fee ownership and the royalties associated with it were not affected by the Settlement Agreement and are not at issue here.

3. The mineral deposits found in the leased lands, including the Peters and Cloquet leases, consisted of sedimentary beds of banded magnetite in silicious gangue known as taconite, lying nearly flat, without rock cover, and with light overburden of glacial drift. A 1931 report prepared for taxpayer estimated the mineral deposit contained at least 1,500,000,000 tons of minable raw material capable of yielding a minimum of 500,000,000 tons of concentrated product.

4. After its incorporation, taxpayer made an effort to exploit its Mesabi range iron ore deposits, expending approximately $6,400,000 in cash in the development of the enterprise. For various reasons, however, taxpayer was unable to concentrate the iron content of the ore on a profitable basis and consequently suspended all mining operations in May 1924. Mining of these iron ore deposits was not commenced again until 1956.

5. On March 31, 1939, the total liabilities of Mesabi, including borrowed funds and interest thereon, amounted to approximately $258,000. In order to pay its debts and also to provide for the future development of the iron ore deposits, taxpayer undertook negotiations with Reserve Mining Company (Reserve), a newly formed Minnesota corporation organized by Oblebay, Norton & Co., a firm engaged in the business of mining and selling iron ore from the Lake Superior district. Oglebay, Norton & Co.

organized Reserve for the purpose of developing the Mesabi properties. The original stockholders of Reserve, as of October 6, 1939, were: Armco Steel Corporation (Armco) (33⅓ percent), Wheeling Steel Corporation (33⅓ percent), Montreal Mining Company (23⅓ percent), and Cleveland-Cliffs Iron Company (10 percent). Subsequently, changes in the stock ownership of Reserve occurred and, from January 3, 1952, to the present, Armco and Republic Steel Corporation (Republic) have each owned a one-half interest in Reserve.

6. At a special meeting held on June 28, 1939, the Mesabi stockholders adopted a resolution authorizing the board of directors and the proper officers of Mesabi to grant Reserve an option to acquire by assignment the Peters and Cloquet leases and to lease from Mesabi all the Mesabi lease lands. Mesabi granted such an option to Reserve on July 25, 1939, and Reserve exercised the option on October 17, 1939. Pursuant to its agreements with Mesabi, Reserve paid Mesabi $269,491.04 to satisfy Mesabi's liabilities, including those which had accrued to the date of the exercise of the option. Once Reserve exercised its option, it was thereafter in possession of substantially all of Mesabi's property.

7. The assignment of the Peters lease provided, among other things, that Reserve would pay to taxpayer 33⅓ percent of the net profits, as defined in the agreement, received by Reserve each calendar year from its operations carried on under the Peters lease. The lease of the Mesabi Lease Lands (hereinafter referred to as the Mesabi lease) provided in part as follows:

> The parties * * * recognize that it is impossible to set any definite basis of determining the price at which products from the lands covered by the Peters lease or this lease shall be sold but it is the intent of the parties hereto that in the sale of products from the lands covered by the Peters lease and this lease that the Lessee shall endeavor to procure the highest current price known to exist in an independent competitive market for material of like value in use and for like quantities. The Lessee shall not in any of its transactions under said Peters lease or this lease intentionally subordinate the interest of the Lessor [taxpayer] to the interest of any shareholder or shareholders or affiliate of the Lessee or any other person, firm or corporation.

The Mesabi lease also provided for the establishment of a permanent board of arbitration, consisting of a representative from both the taxpayer and Reserve. The lease provided that the arbitration board would have the power as follows:

> * * * [U]pon the written concurrence of both of its members, to determine every question which may arise under this lease or under said assignment of the Peters Lease or said Cloquent Lumber Company Lease. If they fail to agree they shall name a disinterested third party, and the question in dispute shall be submitted to the three, and a decision of a majority thereof shall be final and binding upon both parties; * * *.

8. During 1942, 1943, and 1944, Reserve purchased from third parties 148,700 shares of taxpayer's capital stock at a cost of $211,935.50. These purchases were made on behalf of Reserve by Raymond B. Hindle through Hayden, Stone & Company, a New York stock brokerage house. The purchases were made through private transactions and also through the American Stock Exchange (formerly the Curb Exchange). The purchases were made in such a manner as to reduce the chance that market analysts would take notice of Hayden, Stone's purchasing efforts. Transactions were made in small share amounts and no standing "buy" orders were placed. During the time of these purchases, Mr. Hindle was the comptroller of Hayden, Stone & Company and was also secretary-treasurer and a director of taxpayer . The purchases were recorded by Hayden, Stone & Company in a numbered account.

9. During the years 1942, 1943, and 1944, Mr. Hindle advised the officers and directors of taxpayer as to Reserve's purchases of taxpayer's capital stock from third parties, so that by the end of 1944 taxpayer's officers and directors knew that Reserve had purchased 148,700 shares of Mesabi stock. Though many more shares of Mesabi common stock than that purchased by Reserve were available for purchase on the open market during the years 1942, 1943, and 1944, taxpayer had no funds available for the purchase of such stock.

10. After World War II, representatives of Reserve on numerous occasions discussed with representatives of taxpayer the possibility of modifying the Mesabi lease and the assignments of the Peters and Cloquet leases by, among other things, changing the provisions providing for taxpayers to receive one-third of Reserve's net profits from Reserve's operations under the Peters lease to provide for taxpayer to receive a fixed royalty . Between 1947 and 1952, several offers and counter-offers regarding an appropriate royalty figure were made, but the parties were unable to reach an agreement. Throughout this period, taxpayer's officers and directors were of the opinion, and communicated such opinion to Reserve's representatives, that any substantial modification of the taxpayer-Reserve agreements would require approval of taxpayer's stockholders.

11. Between 1951 and 1956, Reserve constructed (1) a power plant, concentrator, and pelletizing plant at Silver Bay, Minnesota, on Lake Superior; (2) a gyratory crusher at Babbit, Minnesota, a mine site on the Mesabi Range; and (3) a 47-mile railroad from Babbit to Silver Bay. The original capital costs to Reserve were approximately $170,000,000. Of this capital $35,000,000 was advanced by Reserve's two stockholders, Republic and Armco, and the remaining $143,000,000 was borrowed by Reserve from institutional investors. These loans were secured by a mortgage on substantially all of Reserve's properties and interests, including the 148,700 shares of Mesabi stocks owned by Reserve. Reserve also assigned to the trustee for the institutional investors a 1953 agreement between Reserve, Republic, and Armco. Under this ore agreement, Republic and Armco were obligated (1) to accept all the Iron ore produced or mined by Reserve each year and (2) to reimburse Reserve for all of its costs and expenses. The ore agreement also provided that current market value was to be used, in lieu of actual reimbursement to Reserve, for all purposes in determining the payments to be made to taxpayer under the Mesabi lease and assignments of the Peters and Cloquet leases.

12. Reserve resumed mining operations on the Peters lease lands in 1956. By that time, due to the depletion in the United States of direct shipping ores (ores which could be shipped directly from the mine for use in a blast furnace and which contain approximately 50 percent iron content), deposits of low content ores, including taconite, had become important to consumers of iron ore. Processes had also been developed to treat and concentrate low grade ores, including taconite, by crushing, grinding, concentrating and other methods, to produce ore concentrates of sufficiently high iron content to be usable in the production of iron and steel. Methods had also been developed to process the concentrated ore into pellets. The taconite pellets produced by Reserve contained approximately 61 percent iron content. When mixed with natural iron ores or used exclusively in a blast furnace, these taconite pellets effected substantial savings in the cost of producing pig iron due to their uniformly high iron content and the uniformly excellent structure of the pellets. Mesabi consistently maintained during the period prior to the Settlement Agreement that if an open market had existed for the taconite pellets, Reserve's pellets would have been purchased at a price substantially higher than that paid for direct shipping ores of equivalent iron content.

13. The gross tonnages of crude ore processed by Reserve from the Peters lease land and the gross tonnages of pellets shipped by Reserve from 1956 through 1959 were as follows:

Year	*Gross Tonnages of Crude Oil Processed*	*Gross Tonnages of Pellets Shipped*
1956	10,933,769	3,497,430
1957	14,374,255	5,027,557
1958	13,111,803	5,031,951
1959	10,175,897	3,968,463
Total	48,595,724	17,525,401

The total production was sold to Republic and Armco.

14. Commencing in the year 1953 and for each year thereafter through the year 1959, Reserve submitted to taxpayer reports of its operations carried on under the Peters lease. Upon submission by Reserve to taxpayer of the report for 1953 and for each report thereafter, taxpayer notified Reserve that it did not accept the reports as complying with the terms of the Mesabi lease and the assignments of the Peters and Cloquet leases. Consequently, numerous disputes arose between taxpayer and Reserve as to the correctness of Reserve's computations of the results of its operations under the Peters lease from which the taxpayer was to receive one-third of the net profits.

15. On May 4, 1955, taxpayer requested arbitration in accordance with the arbitration clause of the Mesabi lease (see finding No. 7), as to the proper treatment to be accorded Reserve's operations during 1953 and 1954. By letter dated November 15, 1955, Reserve also made a formal demand for arbitration. Just prior to the date when hearings before the board of arbitration were scheduled to begin, the parties entered into a settlement agreement, dated February 14, 1956, regarding the net losses incurred by Reserve from 1953 to 1955. This agreement provided

(1) that the net losses for the period prior to January 1, 1956, when properly determined would be amortized in equal annual amounts over a thirteen-year period from 1956 to 1968, and (2) that any net losses of Reserve from operations under the Peters lease after January 1, 1956, when properly determined, would be applied against net profits thereafter accruing until such losses were recovered. In arriving at the amount of net profits which was to be split one-third to taxpayer and two-thirds to Reserve, taxpayer was to bear one-third of Reserve's accumulated net losses and Reserve was to bear two-thirds of its accumulated net losses.

16. At the time of the settlement agreement dated February 14, 1956, Reserve had taken the position that the accumulated net losses to December 31, 1955, amounted to \$17,956,278.01. Thereafter, Reserve made revisions pursuant to the determinations of the board or arbitration on October 11, 1957, and adjusted accumulated net loses to December 31, 1955, to 18,421,844.23. As of the date of the settlement agreement, dated February 19, 1960, the amount of accumulated net losses remaining to be amortized, according to Reserve's computations, totaled \$12,753,584.46 (9/13 of 18,421,844.23). Taxpayer asserted in the arbitration proceedings that the accumulated net losses to December 31, 1955 should be reduced to \$15,314,582.19, and in accordance with taxpayer's position, the amount of accumulated net losses remaining to be amortized on February 19, 1960, totaled \$10,602,403.02 9/13 of \$15,314,582.19).

17. Subsequent to the settlement agreement dated February 14, 1956, twenty-one questions were submitted to the two-man board of arbitration. On October 11, 1957, the two-man board issued five written determinations resolving some of the questions submitted. In a document dated October 30, 1957, entitled "Certification of Questions", the two-man board indicated that it had failed to resolve eleven

of the questions submitted to it and consequently was referring those questions to a three-man board of arbitration.

18. In March 1957, Isaac Putterman, Robert L. Levine, and Barbara G. Mayer, stockholders of taxpayer, filed a derivative action in the Delaware Court of Chancery on behalf of taxpayer against Reserve and the then members of taxpayer's board of directors, seeking, among other things, an accounting with respect to the Mesabi-Reserve lease agreements, cancellations of the lease agreements, return of the property covered by the agreements to taxpayer, and a judgment against members of taxpayer's then board of directors for damages allegedly caused by their failure to prosecute taxpayer's claims against Reserve. The plaintiffs alleged that a proper accounting would disclose that Reserve was indebted to taxpayer in the approximate amount of $8,000,000 for operations during 1956. The plaintiffs in the derivative action attempted to obtain personal jurisdiction over Reserve, a non-resident, pursuant to 10 Del. Code § 366, and on March 25, 1957, the Delaware Court of Chancery appointed a sequestrator who subsequently sequestered the 148,700 shares of Mesabi stock owned by Reserve, The sequestration of the Mesabi stock was still in effect and the derivation actin was still pending on February 19 and April 22, 1960.

19. Prior to the annual meeting of taxpayer's stockholders held on April 18, 1958, a proxy fight occurred within taxpayer. The central issue, asserted by a group led by Arnold Hoffman (now deceased) and Gilbert Haas, was the liability of existing management to represent adequately the interests of taxpayer's stockholders. Mr. Hoffman retained the New York law firm of Gallop, Climenko & Gould to assist him in the proxy contest. In a very close vote, 525,642 shares to 506,853 shares, new management headed by Mr. Arnold Hoffman won control of taxpayer even though Reserve voted its 148,700 shares in favor of taxpayer's old management.

20. In view of the voting by Reserve for old management and because of the prior failure of old management to obtain any favorable results for Mesabi in the arbitration proceedings, the new directors of Mesabi retained the law firm of Gallop, Climenko & Gould as general counsel and requested Mr. Jesse Climenko to make a thorough study of the Mesabi-Reserve arbitration proceedings. Upon completion of his study of the proceedings, Mr. Climenko concluded and recommended to Mr. Hoffman that Mesabi should extricate itself from the arbitratin proceedings and pursue its claim for past profits in a court of law. Thereafter, taxpayer's management advised its stockholders that after reviewing the special counsel's report of the arbitration proceedings, "as well as fully considering Reserve's attitude as revealed in the recent discussions," the directors had concluded that in order to compel Reserve to make a strict accounting to taxpayer in accordlance with its contractual obligations and obtain a ruling as to possible breaches of contract on Reserve's part, the most effective course of action was to present taxpayer's case in a court of law.

21. On June 13, 1958, Reserve filed an action in a Minnesota state court against taxpayer and the principal officers and all the members of taxpayer's board of directors to compel taxpayer to resume arbitration and to enjoin all action inconsistent with arbitration, or, in the alternative, to have the court determine the matters in dispute beween the parties. On June 30, 1958, taxpayer's motion to remove the action to the Federal District Court for the District of Minnesota was granted. Taxpayer thereafter filed two counterclaims: the first sought damages from Reserve, Republic, and Armco in the amount of $16,166,667 as taxpayer's one-third share of the net profits from the operations under the Peters lease for the years 1956 and 1957; the second was brought under the Clayton and Sherman Antitrust Acts and sought treble damages of $37,500,000 from

Reserve, Republic, and Armco. A principal reason for asserting the antitrust counterclaims, according to taxpayer, was to keep the case before a court of law and removed from the secrecy of the arbitration proceedings.

22. On March 30, 1959, the United States District Court for the District of Minnesota issued a memorandum order requiring Mesabi to return to arbitration, but at the same time, dissolved a restraining order previously issued by a Minnesota state court. The District Court ruled that the question of taxpayer's right to assert antitrust claims would be held in abeyance. On appeal, the Eighth Circuit Court of Appeals decided, on October 7, 1959, that taxpayer was entitled to a trial with respect to the defenses it asserted in response to Reserve's action to compel arbitration. Thereafter, the Minnesota District Court permitted taxpayer to file its counterclaim based on antitrust violations and further permitted the joining of Republic and Armco as additional parties to the litigation.

23. On June 16, 1958, taxpayer's new management advised taxpayer's stockholders that it was taking steps to assume the plaintiff's position in the stockholder derivative action pending in the Delaware court. Taxpayer also advised the shareholders that at a meeting with representatives of Reserve, Reserve had rejected a proposal to settle the taxpayer-Reserve differences by using the fixed royalty figure suggested by taxpayer, and that the nearest approach to a counterproposal by Reserve was a discussion of the fixed royalty figure which Reserve had suggested to taxpayer in 1950. Taxpayer advised its shareholders that Reserve's suggestion had been unacceptable to taxpayer in 1950 and if offered again by Reserve would likewise be rejected.

24. In April 1959, taxpayer instituted an action against Republic and Armco in the United States District Court for the District of Delaware alleging violations of the anti-

trust laws and seeking (1) treble damages of $67,500,000 and (2) a mandatory injunction requiring Reserve to offer the taconite pellets produced by it to any and all users or buyers thereof on a competitive basis. Taxpayer alleged that it had sustained damages of $22,500,000, the premium value of the taconite pellets of which it was being short-changed on the accounting for profits. The Delaware District Court stayed the proceeding pending taxpayer's appeal to the Eighth Circuit from the Minnesota District Court's memorandum order. (See finding No. 22) This action was pending on February 19 and April 22, 1960.

25. In April 1959, taxpayer filed an action in the Delaware Court of Chancery against Reserve and Raymond B. Hindle seeking to obtain the 148,700 shares of Mesabi common stock (subsequently increased to 163,570 shares by reason of an 11 for 10 stock split on May 1, 1959) purchased by Reserve from third parties during the period from 1942 to 1944. Taxpayer was concerned that Reserve might again attempt to dominate taxpayer by voting the 148,700 shares (12.34 percent) of Mesabi stock which it held against taxpayer's interests and so viewed the lawsuit as a means of forcing Reserve to relinquish control of such shares. Taxpayer alleged that Reserve and Hindle conspired in the early 1940s to have Hindle violate his fiduciary duties to taxpayer by diverting to Reserve the opportunity to buy shares of Mesabi stock at favorable market prices and by withholding, during the period of the stock purchases, current material information concerning the status of Reserve's plans and operations in order to keep the market price of the stock at a low level. Taxpayer sought damages and losses as a result of the alleged breach of trust by Hindle and also sought to impose a constructive trust on the shares of Mesabi stock owned by Reserve. Taxpayer attempted to obtain personal jurisdiction over Reserve, a non-resident, pursuant to 10 Del. Code § 366, and the Court, on April 17, 1959, issued an order of

sequestration with respect to the shares of Mesabi stock owned by Reserve. The sequestration order, while providing that all right, title and interest in the shares was in the sequestrator who was to hold and preserve them until further direction of the court, also provided that the shares could be sold upon direction from defendants upon provision of security of equal amount.

26. By January 1960, the three-man board of arbitration had completed hearings on all questions except the question of the propriety of Reserve's taconite pellet pricing on sales to Reserve's two stockholders, Republic, and Armco. On January 21, 1960, Wesley A. Sturges, the disinterested third arbitrator, ruled that Reserve should turn over to taxpayer Reserve's records dealing with pricing of taconite pellets charged to Republic and Armco. Thereafter, the hearings were adjourned until March of 1960 when testimony was to be taken on the question of pellet pricing. No decision was rendered by the three-man board on any of the questions submitted for arbitration.

27. Included among the questions pending before the three-man board of arbitration on February 19 and April 22, 1960, were those related to the following issues:

(a) The pricing by Reserve of pellets delivered by it to its two stockholders. Reserve in its reports to taxpayer used the price quoted in the ore market for Old Range Non-Bessemer direct shipping ore adjusted for iron content, whereas taxpayer claimed the pellets should have been priced at a substantial premium over prices paid for direct shipping ore.

(b) The deduction by Reserve of a tariff charge in lieu of the actual cost incurred for (1) rail haulage of semi-crushed ore from the crusher located near the mine to the site of later processing of the ore at Silver Bay, Minnesota, (2) power generation at Silver Bay, and (3) dock and harbor operations.

(c) The deduction by Reserve of certain interest and finance costs.

28. The questions pending before the two-man board of arbitration on February 10 and April 22, 1960, included those relating to (a) deduction by Reserve of expenses of operating townsite properties; (b) deduction by Reserve of losses on the sale of townsite properties; (c) allocation by Reserve of income and expenses between properties covered by the leases and other properties operated by Reserve; (d) deduction by Reserve of depreciation on the milling and processing plant at Silver Bay; and (e) deduction and treatment by Reserve of management and other expenses, leasehold expenses, maintenance and repairs and Reserve's cost of arbitration.

29. (a) Taxpayer's claims for royalty income for the years 1956, 1957, and 1958, as set forth in the document entitled "Mesabi Iron Company Restatement of Net Profits of Reserve Mining Co. for Mesabi Report," and submitted to the board of arbitration, amounted to $9,808,542.70, not including taxpayer's claim that the taconite pellets should have been priced at a substantial premium over prices paid for direct shipping ore.

(b) Taxpayer, in its reports to its shareholders, consistently stated that the price at which Reserve sold the taconite pellets to its two stockholders (Armco and Republic) did not include any amount for the premium value of the pellets. According to taxpayer's expert, University of Minnesota Professor Thomas L. Joseph, a ton of pellets was worth from $4.27 to $4.37 per ton more than the equivalent amount of direct shipping ore. Taxpayer's other experts, Odin A. Sundness, a director of taxpayer, and Harold Cope, agreed with Professor Joseph's findings and conclusions.

(c) Taxpayer's claims for royalty income for the years 1956, 1957, and 1958 also included $18,075,917 for the pre-

mium value of the 13,556,938 tons of pellets shipped by Reserve in those years. Taxpayer's theory of recovery of such royalties was based upon the premise that it was possible for companies to realize substantial savings in their blast furnace operations through the use of taconite pellets rather than unprocessed direct shipping ores. On this account, taconite pellets sold for more in the open market than did the unprocessed direct shipping ores.

Taxpayer's claim on the premium value of the pellets was speculative in nature. In order for it to win its argument, it was necessary for taxpayer to prove that Republic and Armco experienced substantial savings as a result of their use of the pellets. In addition, taxpayer would have also had to interpret the 1939 Mesabi-Reserve lease agreement provision indicating that the price for the pellets should be based upon the "* * * market for material of like value * * * for like quantities" to recognize separate markets for taconite pellets and direct shipping ore of the same iron content. It was Reserve's contention that the only available market for arriving at a sales price was the market for direct shipping ores.

(d) While the year 1959 was not formally included in the arbitration proceedings, taxpayer did not accept Reserve's computations of net profits for 1959. These computations indicated a net profit of $1,984,406.31, one-third of which was payable to taxpayer ($661,468.77). Taxpayer's claim for additional royalty income for the year 1959 would have been based on the same issues asserted for the years 1956, 1957, and 1958. While the precise amount of this claim is not known, taxpayer has asserted that its total claim, attributable to issues other than the pricing of the pellets, would have been approximately $1,500,000. In addition, 3,968,463 tons of pellets were shipped by Reserve in 1959.

30. According to the testimony of Jesse Climenko, a partner in the firm of Gallop, Climenko & Gould, counsel to Mesabi, as of early 1960, Mesabi's litigation objectives were

to divest Reserve of its stock ownership in Mesabi, to end the arbitration, and to get a fixed royalty per ton rather than the ⅓ net profit figure.

31. In early February 1960, the managements of taxpayer and Reserve reached agreement as to what they considered to be a sound basis for settlement of all the issues between them. As part of the settlement, Reserve was to transfer the shares of Mesabi stock it owned to taxpayer. Taxpayer saw the settlements as a means of terminating Reserve's ability to affect taxpayer's corporate decision-making process by means of voting the 12.34 percent stock interest which Reserve held in taxpayer.

32. On February 18, 1960, representatives of both taxpayer and Reserve prepared and agreed upon a draft designed to effectuate such Settlement Agreement. This agreement was prepared by counsel for taxpayer and Reserve and was thereupon presented to the boards of directors of both companies on February 19, 1960. Counsel for both companies recommended its adoption.

33. At a special meeting of taxpayer's board of directors held on February 19, 1960, the recommended basis for settlement of the controversies reached between the managements of taxpayer and Reserve was discussed and unanimously approved. Taxpayer's president was authorized to settle all issues between taxpayer and Reserve and to execute any agreements or other instruments embodying the provisions of the proposed settlement subject, however, to the provision that all such agreements or instruments would have to be approved by the many Mesabi stockholders.

The two stockholders and directors of Reserve also considered and approved the proposed settlement on February 19, 1960.

34. The pertinent corporate resolutions adopted at the February 19 meeting were as follows:

> Resolved, that the President of Mesabi be and he hereby is authorized and empowered to settle and resolve all issues raised between Mesabi and Reserve in the pending litigation and arbitration upon substantially the following terms and the terms set forth in these resolutions:
>
> Reserve is to assume all unamortized pre-production expenses which hitherto have been charged to Mesabi on the basis of a thirteen-year amortization period commencing January 1, 1957, and Mesabi is to receive the sum of $400,000 in cash. Reserve is to have no further obligation to Mesabi with respect to taconite products produced and sold to 1960. Commencing January 1, 1960 Reserve's agreement to pay Mesabi 33⅓% of the net profits is to be deleted and in place thereof Reserve will agree to pay to Mesabi a base royalty of $1 per ton of taconite product based upon an iron content of 61% iron natural, which is produced from the Peters Lease Lands and the Cloquet and Mesabi Lease Lands which is produced and shipped by Reserve on or after January 1, 1960. * * *
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> * * * * * * * * *
>
> Resolved, that the 163,570 shares of capital stock of Mesabi which Reserve owns and with respect to which Reserve is to transfer all of its right, title and interest to Mesabi subject only to the sequestration orders affecting said shares, be accepted and received by Mesabi; and it was further
>
> Resolved, that the lawsuit filed by Mesabi in the Delaware Court of Chancery in Wilminton against Reserve seeking to recover said shares of capital stock be dismissed with prejudice as to Reserve in a manner satisfactory to Reserve; and it was further
>
> Resolved, that steps satisfactory to Reserve be taken for the dismissal with prejudice of all other actions or counterclaims of Mesabi, including the action brought by stockholders of Mesabi in the Delaware Chancery Court, against Reserve and each of its stockholders, Republic Steel Corporation and Armco Steel

> Corporation, that steps satisfactory to Mesabi be taken for dismissal with prejudice of Reserve's action against Mesabi in the United States District Court at Duluth, and that the arbitration proceedings between Reserve and Mesabi be terminated; and it was further
>
> Resolved, that all further proceedings in the arbitration and in all pending litigation be suspended pending the consummation of the proposed settlement; and it was further
>
> Resolved, that the President of Mesabi be and he hereby is authorized and empowered to execute, acknowledge and deliver on behalf of Mesabi any agreements or other instruments in form to be approved by general counsel for Mesabi embodying the provisions of the proposed settlement substantially as outlined above, with such changes therein or additions thereto as the President in his discretion may determine, subject, however, to the provisions to be contained in any said agreements or instruments that the same shall be subject to the approval of the stockholders of Mesabi as hereinafter set forth; and it was further
>
> Resolved, that a special meeting of the holders of the capital stock of Mesabi be called for April 15, 1960, or on such other date as may be fixed by the President, and at such time and place as shall be determined by the President, to consider and act upon the agreements entered into between Mesabi and Reserve embodying the settlement, and that the affirmative vote of a majority of all the outstanding shares of capital stock of Mesabi (excluding from such majority the shares of capital stock owned by Reserve) to be required for the approval of said agreements; and it was further
>
> Resolved, that the close of business on March 17, 1960 or such other date as may be fixed by the President be and hereby is fixed as the record date for stockholders entitled to receive notice of and to vote at the special meeting of stockholders to be held April 15, 1960 to consider and act upon the said settlement agreements; and it was further
>
> Resolved, that Arnold Hoffman, Quincy A. Shaw, Jr. and Gilbert M. Haas be and they hereby are desig-

nated as proxies for Mesabi to vote any proxies received by Mesabi; and it was further

RESOLVED, that the proper officers of the corporation together with counsel are hereby authorized and empowered to prepare a proxy statement and such other material as may be necessary or desirable in connection with the solicitation of proxies, to file the same with the Securities and Exchange Commission, and thereafter to take such further action as may be necessary or desirable in connection with the distribution of said proxy material to the stockholders of Mesabi, and it was further

RESOLVED, that upon the approval of the said agreements by a majority of the outstanding capital stock of Mesabi (excluding from such majority the shares of stock owned by Reserve) the President be and hereby is authorized and empowered to execute, acknowledge and deliver such agreements, instruments or other documents which may be necessary or desirable in the opinion of general counsel of Mesabi to implement the provisions of the settlement agreements or to carry out the purposes of the settlement and of these resolutions, said agreements, instruments and documents to contain substantially the terms set forth in these resolutions with such changes therein or additions thereto as the President in his discretion shall determine.

35. In the course of considering the settlement proposal on February 19, 1960, taxpayer's board of directors discussed the terms of the settlement among themselves and with Lester J. Tanner, a partner in the law firm of Gallop, Climenko & Gould, Mr. Tanner advised the directors that \$7,000,000 was the maximum amount that reasonably could be expected for taxpayer's pre-1960 claims and therefore a payment by Reserve of \$7,000,000 (the 163,700 shares of Mesabi stock at \$40⅜ per share plus \$400,000) was essentially a complete victory on the complicated accounting claims then in arbitration.

36. Mr. Tanner also explained to taxpayer's board of directors that he believed that as a result of the settlement the maximum amount subject to taxes would be \$7,000,000

of ordinary income (163,700 shares of Mesabi stock at 40 plus \$400,000). Mr. Tanner testified that the figure of \$40 per share was used since the tax estimate was prepared after the close of trading on February 18, 1960, on which date the Mesabi stock closed at 40⅜. Mr. Tanner speculated to the directors that argument could be made that the receipt of shares constituted a redemption or a sale of a capital asset, but that such argument would probably not be successful since Reserve was insisting that the settlement payment relate to taxpayer's pre-1960 net profits claim against Reserve. The settlement proceeds, consequently, were most likely to be treated as ordinary income.

37. On February 20, 1960, taxpayer announced publicly the terms of the Settlement Agreement and stated that the company would receive 163,570 shares from Reserve "reducing Mesabi's outstanding stock from 1,325,389 to 1,161,930 shares, or a reduction of 12.3402%." The Settlement Agreement was reported by the press on February 22 and 23, 1960. The press also reported one month later, on March 22 and 23, that taxpayer was considering a plan aimed at avoiding double taxation of its shareholders. Various brokerage houses had previously reported favorably concerning the settlement and the possible elimination of income tax at the corporate level by taxpayer. On April 7, 1960, Reserve issued a public announcement indicating that it planned to greatly expand its annual production. Such an expansion had been rumored from the date of the Settlement Agreement. As a result of these activities, numerous brokerage houses recommended the Mesabi stock as a good investment. Emphasis was given in these reports to the favorably royalty payments, the possible change from the corporate structure to eliminate corporate income tax, the estimates of iron ore reserves, and Reserve's intention to expand production.

38. The formal settlement agreement dated February 19, 1960, was signed by taxpayer's president on February 28, 1960, and by Reserve's president on March 2, 1960.

39. Relevant portions of the Settlement Agreement are as follows:

"2. Subject to the conditions hereof Research shall, at the Closing, (a) pay to Mesabi $400,000, and (b) assign to Mesabi all of Reserve's right, title and interest in all of the shares of common stock of Mesabi owned by Reserve (which Reserve represents total 163,570 shares), free and clear of all claims, liens and encumbrances, including, without limitation, the lien of the First Mortgage, dated December 1, 1952, from Reserve to Chemical Bank & Trust Company, as Trustee, so that Reserve shall have no further interest therein and with the intent that said shares of stock shall belong to Mesabi, provided, however, that said shares shall be assigned subject to any restriction of law or claim, lien or encumbrance resulting from the sequestration orders of and proceedings in the Court of Chancery of the State of Delaware in and for New Castle County in the above-mentioned actions there pending; and Reserve shall cooperate with Mesabi at or after the Closing to discharge any claim, lien or encumbrance resulting from said sequestration orders, provided that in such cooperation Reserve shall not be required to appear generally in said actions or incur any liability in connection therewith. Reserve shall, at the Closing, deliver Certificate No. 5242, representing 148,700 of said shares, duly endorsed in blank for transfer, and stock powers in blank covering the remaining 14,870 of said shares represented by Certificate Nos. C 52446 through C 52953 inclusive and CO 23826, which certificates are in the possession of Mesabi, with signatures guaranteed, with requisite federal and state transfer tax stamps affixed, and if requested by Mesabi, accompanied by a corporate resolution by the Board of Directors of Reserve authorizing the transfer thereof to Mesabi. In consideration of such payment and assignment, Mesabi hereby releases Reserve, effective at the Closing, from any further obligation to Mesabi with respect to payments under the Assignment and the Mesabi Lease for products produced prior to January 1, 1960, from the lands covered by the Peters Lease and other mineral bearing

lands leased or assigned by Mesabi to Reserve, whether or not such products were shipped by Reserve prior to such date.

"3. Subject to the conditions hereof, Mesabi and Reserve, at or prior to the Closing, shall cause the above-mentioned arbitration proceedings to be terminated.

"4. Subject to the conditions hereof, Mesabi and Reserve, at or prior to the Closing, shall (a) stipulate for the dismissal with prejudice of all pending actions or counterclaims of either of them against the other, its present and former officers, directors or stockholders, and (b) cause to be dismissed by stipulation of the necessary parties thereto, or move to dismiss, the above-mentioned *Putterman* v. *Daveler* action and take all steps reasonably necessary to secure a prompt dismissal of such action.

"5. Subject to the conditions hereof, effective at the Closing, each party hereby releases the other party, its present and former officers, directors and stockholders in whatever capacity, from all claims, demands, actions or causes of action of any kind or nature, other than the obligation of Reserve released by Mesabi pursuant to paragraph 2 above, asserted in the above-mentioned arbitration and actions pending in the courts and from all other claims, demands, actions or causes of action of any kind and nature which either party might have against the other party, its present and former officers, directors or stockholders in whatever capacity, or any of them, arising in any way out of any action, inaction, default or alleged default which occurred prior to the Closing, excepting, however, any right, claims, demands, actions or causes of action of any kind or nature arising out of or created by this agreement.

"6. Mesabi represents that the matters covered by this agreement have been unanimously approved by its board of directors and that such board will recommend approval and authorization of this agreement by Mesabi's stockholders. Mesabi shall submit this agreement to its stockholders for approval and authoriza-

tion, with such recommendation of its board of directors, at a meeting to be held not later than April 22, 1960, and will use its best efforts to obtain the highest possible number of shares to be voted at such meeting or any adjournment or adjournments thereof, but such adjournment or adjournments may not be to a date later than May 31, 1960, or such later date as Reserve may approve in writing. Reserve represents that its execution of this agreement has been duly authorized by its board of directors and its stockholders.

"7. Proceedings by Mesabi, Reserve, Republic and Armco in the above-mentioned arbitration and actions pending in the courts and payment of any sums which, except for this agreement, would be payable by Reserve to Mesabi under the Assignment or the Mesabi Lease, shall be suspended during the period from the date hereof until the action by Mesabi's stockholders at the meeting referred to above, and until the Closing if the stockholders vote for approval as hereinafter specified. After the Closing Reserve shall have no obligation to pay the sums so suspended.

"8. Performance of the obligations of Mesabi and Reserve set forth in paragraphs 1 through 5 above are subject to the conditions that approval and authorization shall have been given by the affirmative vote of a majority of all the outstanding shares of Mesabi, excluding from such majority the shares owned by Reserve.

"9. The Closing shall be held on the fifth business day following the close of the meeting of Mesabi's stockholders approving and authorizing the matters covered by this agreement as hereinbefore provided at the office of Republic, Republic Building, Cleveland, Ohio, or at such other time and place as Mesabi and Reserve shall theretofore mutually agree. If the Closing is not held, this agreement shall become null and void and shall be without prejudice to Mesabi, Reserve, Armco and Republic, and their respective present and former officers, directors and stockholders."

40. On March 4, 1960, taxpayer's board of directors held a special meeting at which it was decided that the

Annual Meeting of its stockholders, scheduled for April 15, 1960, would be deferred until April 22, 1960, so that a joint annual and special meeting of stockholders could be held for the purpose of electing directors and acting upon the Settlement Agreement. As of the record date for the vote, March 18, 1960, Mesabi had over 2700 individual and 250 institutional shareholders. No individual directly owned more than 37,154 shares, and most individuals held fewer than 100 shares.

41. The express condition of the Settlement Agreement requiring that it be approved and authorized by the affirmative vote of a majority of the outstanding shares of taxpayer, excluding from the majority the shares owned by Reserve, was a condition insisted upon by Reserve and was in accordance with taxpayer's previously established policy of obtaining stockholder approval for any substantial modification of the Mesabi-Reserve contractual relationship. All documents pertaining to the settlement expressly recognized and provided that the proposed settlement was subject to the condition that it be approved and authorized by the affirmative vote of a majority of the outstanding shares of taxpayer, excluding the shares owned by Reserve.

42. On March 21, 1960, taxpayer mailed to its stockholders a *Notice of Joint Annual and Special Meeting of Stockholders,* a proxy statement (dated March 18), and a proxy, and taxpayer's annual report for 1959. The proxy statement stated in part that the settlement would be consummated on the fifth business day following the close of the meeting of taxpayer's stockholders, if the settlement was approved by the stockholders. The proxy statement also indicated that the affirmative vote of a majority of all the outstanding shares of taxpayer, excluding the shares owned by Reserve, was required for approval and authorization of the settlement agreement. The proxy statement, however, (1) did not indicate that the $400,000 in cash and

Mesabi stock were to be received in settlement of only taxpayer's claims for royalty income, and that taxpayer was to receive no consideration from Reserve, Republic, and Armco for dismissing its antitrust claims; (2) did not set forth the value of taxpayer's claims for royalty income which taxpayer's board of directors or legal counsel may have placed on such claims; and (3) did not refer to the market price of Mesabi stock on February 18 or 19, 1960, or at any other time.

43. On April 22, 1960, the meeting of taxpayer's shareholders was held and the proposed settlement was approved by a vote of 1,016,049 to 970 shares, the shares owned by Reserve not being voted. The resolution of taxpayer's stockholders provided as follows:

> RESOLVED, that the settlement agreement dated February 19, 1960, between MESABI IRON COMPANY and RESERVE MINING COMPANY be and it is hereby approved and authorized, and the execution thereof by the president of MESABI IRON COMPANY on behalf of said corporation is hereby approved, ratified and confirmed in all respects.

Taxpayer's management never advised the stockholders that in their (the stockholder's) consideration of the proposed settlement they were to consider the value of the 163,570 shares of Mesabi stock to be only $40. Thus, in evaluating the proposed settlement taxpayer's stockholders realistically could have taken into consideration the market price of Mesabi stock on the date they mailed in their proxies (taxpayer's proxy statement was mailed to the Mesabi shareholders on March 21, 1960) or on April 22, 1960, the date of the shareholder vote approving the Settlement Agreement. In either case, the shareholders would have considered a market value considerably higher than on February 19, 1960, the date of the agreement.

44. On April 25, 1960, the court in *Putterman* v. *Daveler* (Del. Ct. Chan.), upon motion of the plaintiffs and also taxpayer, ordered the action dismissed with prejudice and all shares of Mesabi stock owned by Reserve released from the seizure and sequestration. On April 25, 1960, the court in *Mesabi Iron Co. v. Republic Steel Corp. and Armco Steel Corp.* (D. Del.), pursuant to the stipulation of the parties, ordered the case dismissed with prejudice. Also on April 25, 1960, the court in *Mesabi Iron Co.* v. *Raymond Hindle and Reserve Mining Co.* (Del. Ct. Chan.), upon motion of taxpayer, ordered the case dismissed as to Reserve with prejudice and all shares of Mesabi stock owned by Reserve released from the sequestration order. On April 27, 1960, the parties in *Reserve Mining Co.* v. *Mesabi Iron Co.* (D. Minn.) entered into a stipulation of dismissal of the action.

45. On April 27, 1960, Reserve transferred to taxpayer, in accordance with the terms of the settlement, the 163,570 shares of Mesabi stock, a check in the amount of $400,000, and a check in the amount of $1,464,960.85 representing a straight royalty payment based upon production during the first quarter of 1960. The 163,570 shares of Mesabi stock were transferred by Reserve free and clear of any claim, lien, or encumbrance, since on April 25, 1960, such shares of stock had been released from the sequestration orders.

46. No provision of the Settlement Agreement required that taxpayer retire the 163,570 shares of Mesabi stock previously held by Reserve. Taxpayer, however, decided voluntarily to hold the shares of stock it received from Reserve as treasury stock. Taxpayer's management advised the Mesabi shareholders in Interim Report No. 18 issued February 20, 1960, and in a proxy statement required by the Securities and Exchange Commission and filed on March 18, 1960, that the net effect of the settlement would be to reduce taxpayer's outstanding stock by 12.3 percent. Despite disclosing the aforementioned course of action, taxpayer's management made no commitment to refrain from releasing the stock for sale at a future date.

47. On November 11, 1960, over the objection of then director Gilbert Haas that cash was required to meet Mesabi's tax obligations, the corporation issued a cash dividend of $3.00 per share or a total of $3,579,672.

48. On April 6, 1961, taxpayer distributed to its stockholders rights to buy 119,322 shares of stock at $60 per share. The proceeds of the offering, estimated at $7,100,000 after expenses, were to be used as a reserve against possible 1960 tax liability in excess of that conceded by the company and declared on its 1960 return.

49. The number of shares traded in the common stock of Mesabi on the American Stock Exchange, and the closing price, each day for the period of February 1, 1960, through May 2, 1960, was as follows:

1960	*Volume*	*Closing Price*
Feb. 1	300	35¼
2	300	35½
3	1,600	36
4	700	35
5	500	35½
8	2,300	35¼
9	500	35¼
10	500	35⅛
11	300	35
12	4,300	35⅞
15	4,000	35¾
16	6,500	39
17	5,900	39
18	5,300	40⅜
19	22,700	45
23	43,700	52¾
24	10,500	51
25	17,400	50⅛
26	6,600	53⅜
29	11,200	54½
Mar. 1	18,400	58¼
2	13,500	60⅞
3	8,400	56½

1960	*Volume*	*Closing Price*
4	10,500	58¾
7	4,100	58⅞
8	6,700	56¾
9	3,300	58¼
10	2,100	57
11	4,900	57¾
14	3,300	58¾
15	15,200	63¾
16	14,300	67⅜
17	7,800	65¾
18	5,000	69¼
21	6,500	70¾
22	15,800	74¾
23	9,200	72
24	4,700	72⅞
25	4,400	68½
28	5,700	69⅛
29	1,300	69¼
30	5,500	72¼
31	2,100	71
Apr. 1	2,000	71½
4	2,600	73
5	2,200	72
6	5,200	74¼
7	10,600	75
8	3,000	75
11	2,600	74
12	1,400	74⅝
13	5,400	78½
14	6,900	80⅜
18	2,800	80
19	4,200	78½
20	1,900	79
21	4,200	82¾
22	9,600	75½
25	5,400	73½
26	1,800	74¼
27	3,100	71⅝
28	3,100	71¾
29	4,500	73½
May 2	2,400	74¾

50. During 1960, Mesabi traded at a high of 92 and a low of 34¼. From January 2, 1961 through March 30, 1961, the stock traded at a high of 127 and a low of 81½. On March 30, 1961, the high was 127 and the low 118.

51. The mean prices, i.e., the average of the high and low prices, of Mesabi's common stock on February 18, and 19 and April 22, 1960, were as follows:

February 18	$39.9375
February 19	43.1875
April 22	78.25

52. Taxpayer recognized the income from the settlement in its 1960 income tax return, prepared according to accrual acounting principles. Taxpayer reported taxable income of $7,388,676.66, which included gross income in the amount of $7,066,042.20 designated as "Royalty-Additional Income From Settlement of Prior Years Claims." Upon audit of the return, the Internal Revenue Service (IRS) increased the royalty income so reported by $7,717,232.60 solely because of the determination that the market value of the 1963, 570 shares of Mesabi stock was in excess of that reported by taxpayer. In preparing its return, taxpayer used the price of Mesabi stock at the close of the market on February 18, 1960, that being the price considered by taxpayer's board of directors at their February 19, 1960 meeting. Taxpayer also included a downward adjustment of 4¼ dollars per share for "blockage" based upon an opinion from Kuhn, Loeb & Company. In issuing its adjustment, the IRS used a price of 78¼. That value represented the mean price, i.e., the average of the high and low selling prices, of taxpayer's capital stock on the American Stock Exchange on April 22, 1960.

Consistent with its determination that taxpayer realized additional royalty income, the service allowed taxpayer additional deductions for depletion in the amount of $1,159,584.89 and for royalty taxes in the amount of $826,846.35.

53. As a result of the adjustments made to taxpayer's 1960 income tax returns by the IRS, additional income taxes in the amount of $3,016,132.64, plus interest of $239,596.61 were timely assessed against taxpayer. These additional charges were paid in full on November 30, 1962, by the Mesabi Trust, transferee of all the assets of taxpayer. Subsequently, the IRS timely assessed an additional interest charge with respect to income taxes for 1960 in the amount of $65,983.07, which amount was paid in full on April 2, 1963, by the Mesabi Trust.

54. The Agreement of Trust between Mesabi and Bankers Trust Company and the other named trustees was entered into pursuant to the provisions of a plan of complete liquidation of Mesabi Iron Company, duly approved by the board of directors of the company on May 26, 1961, and duly adopted by the stockholders of Mesabi on June 23, 1961. Said plan of complete liquidation provided, among other things, for the transfer by Mesabi of its assets to the Mesabi Trust and Land Trust and for the distribution to the stockholders of Mesabi, in exchange for their shares of the capital stock of Mesabi, of Trust Certificates evidencing beneficial interest in the Mesabi Trust and Land Trust. Section 1.4 of the Agreement of Trust provides that in the event a liability is asserted against the trustees as transferees of the Trust Estate on account of any liability of Mesabi, the trustees may use that portion of the Trust Estate necessary to contest and pay the liability.

55. A certificate of Dissolution of the Mesabi Iron Company was filed in the Office of the Secretary of State of the State of Delaware on July 31, 1961.

56. The Mesabi Trust, transferee of the assets of taxpayer, paid the resulting tax deficiency, filed claims for refund which, to the extent they relate to the issues here, were rejected, and this suit followed.

57. The parties agree that in the event it is determined that taxpayer as a result of its receipt of the 163,570 shares of Mesabi stock realized income in an amount less than 14,335,274.80, the deduction for depletion and royalty taxes claimed by taxpayer on its return for 1960 and those allowed by the IRS upon audit must be correspondingly reduced.

CONCLUSION OF LAW

Upon the foregoing findings of fact ,which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is dismissed.

No. 75-922

In the Supreme Court of the United States

OCTOBER TERM, 1975

BANKERS TRUST COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-922

BANKERS TRUST COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The sole question presented by the petition in this federal income tax case is whether the fair market value of 163,570 shares of petitioner's[1] stock it received in settlement of various claims should be determined by reference to the mean price at which the stock was traded on the American Stock Exchange on April 22, 1960, the date on which petitioner first acquired a fixed, unconditional and enforceable right to receive the stock and the proper date for accrual of the income, or, as petitioner urges, by such price on February 19, 1960, the date on which a conditional agreement was reached by the boards of directors of petitioner and the transferor corporation.

The pertinent facts are as follows: In 1939 petitioner leased lands containing iron ore deposits to Reserve Mining Company ("Reserve") in return for one-third of

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[1]For convenience, we refer to Bankers Trust Company and the Trustees of the Trust holding the assets of Mesabi Iron Company, Dissolved, as "petitioner" (see Pet. App. 1a).

the net profits obtained from the lands (Pet. App. 2a). Numerous disputes arose between petititioner and Reserve concerning Reserve's computations of net profits, and arbitration proceedings and litigation ensued, including a derivative action brought by petitioner's stockholders. Petitioner also brought an antitrust action against Reserve's two shareholders, Republic Steel Corporation and Armco Steel Corporation (Pet. App. 3a-5a).

On February 18, 1960, the negotiators for petitioner and Reserve reached an agreement under which petitioner would receive $400,000 and all of Reserve's stock in petitioner (163,570 shares), petitioner would drop all its claims against Reserve and its shareholders, and the 1939 lease agreement would be modified to provide petitioner with royalties of $1 per ton of iron ore shipped. At Reserve's request, the tentative agreement provided that it would not become effective until approved by a majority of petitioner's outstanding shares, excluding the shares owned by Reserve. The closing was to take place on the fifth business day following approval by petitioner's shareholders. On February 19, 1960, Reserve's directors and its two shareholders and petitioner's directors approved the proposed settlement (Pet. App. 6a). On April 22, 1960, petitioner's shareholders approved the proposed settlement, and on April 27, 1960, petitioner received from Reserve $400,000 and 163,570 shares of petitioner's stock (Pet. App. 8a-9a).

On its 1960 income tax return, petitioner acknowledged that it had received income from the settlement,[2] declaring the shares to have been worth $5,908,966.25 (163,570 shares at $40.375 each—the February 18, 1960 closing price on the American Stock Exchange) less a blockage discount of $4.25 per share. On audit, the Commissioner of Internal Revenue determined that the proper

[2]Petitioner agrees that in these circumstances it realized taxable income upon the receipt of its own shares. Thus, the correctness of the principle stated in Treasury Regulations, Section 1.311-1(e) (26 C.F.R.) is not at issue here.

date for valuing the stock was April 22, 1960, when petitioner's shareholders approved the settlement, and that that value was best evidenced by the mean trading price on the American Stock Exchange that day, *i.e.,* $78.25 (Pet. App. 9a). The Court of Claims, with one judge dissenting, upheld the Commissioner's position that the proper valuation date was April 22, 1960 (Pet. App. 10a-15a), and that the value of the shares on April 22, 1960, was the mean trading price on that day, $78.25 (Pet. App. 15a-23a).

1. Petitioner argues (Pet. 8-11, 17-19) that because a conditional, preliminary agreement was reached by the boards of directors on February 19, 1960, a date on which petitioner's stock was traded on the American Stock Exchange at approximately $40 per share, that market price should control for tax purposes rather than the $78.25 stock exchange price which prevailed on April 22, 1960, the date on which petitioner's shareholders approved the agreement and petitioner's right to receive the stock first became fixed. The Court of Claims correctly held that petitioner's position that the valuation date need not be the same as the income date "runs counter to the basic principle that under the federal income tax system items are taken into income at their then current value" (Pet. App. 10a). The decision accords with *Amerada Hess Corp.* v. *Commissioner,* 517 F.2d 75 (C.A. 3), certiorari denied *sub nom. White Farm Equipment Co.* v. *Commissioner,* No. 75-375, December 15, 1975, which involved a similar issue. See also *Fordyce* v. *Helvering,* 76 F.2d 431 (C.A.D.C.), and *Philadelphia Park Amusement Co.* v. *United States,* 126 F. Supp. 184, 189 (Ct. Cl.).

Until petitioner's shareholders ratified the conditional agreement reached by the boards of directors, the transaction was wholly executory. Nothing of substance occurred or was intended to occur under the settlement until the transaction was ratified by the shareholders. Indeed,

one of the events leading up to the transaction was a derivative suit against both Reserve and the then directors of petitioner.

2. Contrary to petitioner's argument (Pet. 12-15), the decision below does not conflict with *Herbert J. Investment Corp.* v. *United States*, 360 F. Supp. 825 (E.D. Wis.), affirmed *per curiam*, 500 F.2d 44 (C.A. 7). There, the parties executed an agreement on February 26, 1968 (the "agreement date"), which provided for the sale of tangible and intangible assets. The agreement provided that all profits and losses were to accrue solely to the purchaser from the time of transfer of temporary control, and that interest was to be paid to taxpayer-seller from that time until final consummation of the arrangement. Pursuant to Interstate Commerce Commission authority, on April 1, 1968 (the "transfer of control date"), temporary control was assumed by the purchaser, and thereafter the purchaser had a free hand in conducting the business.

The taxpayer reported the sale of assets "as completed for tax purposes" on April 1, 1968, the transfer of control date. However, on audit, the Internal Revenue Service treated the transaction as complete for tax purposes on August 30, 1968 (the "closing date"), the date of final consummation of the agreement (360 F. Supp. at 826). The court held that the proper valuation date was April 1, 1968, the transfer of control date.

In *Herbert J. Investment*, as in the present case, the court accorded no tax significance to the "agreement date." Moreover, petitioner ignores the fact that in *Herbert J. Investment*, the valuation date approved by the court was the time at which beneficial ownership changed. In its opinion in *Herbert J. Investment*, the district court stated (360 F. Supp. at 827-828):

> A sale may be completed for tax purposes despite the existence of future contingencies. * * * The time of transfer of dominion and control over assets which are the subject of a sale is a more important consideration than the time of ultimate payment or conveyance of formal title.

Necessarily embraced in the court's holding, therefore, is the finding that the sale was completed for tax realization and valuation purposes as of April 1, 1968.[3]

In this case, however, petitioner conceded that under its accrual method of accounting the proper reporting date for the income in question was April 22, 1960, the closing date. In its motion for rehearing in the Court of Claims, petitioner attempted to withdraw that concession, which was made in October, 1971, renewed during the trial of this case and made again in petitioner's brief to the Court of Claims (see Pet. App. 10a). But apart from the ineffectiveness of that belated attempt, petitioner's concession was compelled by the facts in this case and the controlling legal principles.

The express condition of the settlement agreement requiring that the proposed agreement be approved and authorized by the affirmative vote of a majority of the outstanding shares of petitioner (excluding from the majority the shares owned by Reserve) was a condition upon which Reserve insisted. It was in accordance with peti-

[3]This is also demonstrated from the brief of Herbert J. Investment Corporation in the court of appeals, which stated (p. 15) that the question of when the sale was completed for tax purposes was before the court:

> The basic legal question here is when, on the facts of this case, the sale was effective for tax purposes—whether the time of the sale of the assets and operating rights of the taxpayer was on August 30, 1968, the date of formal conveyance and passage of title, as the government contends, or as taxpayer contends, on April 1, 1968, the date the parties intended to pass beneficial interest, and did in fact pass the benefits and burdens of ownership to the purchaser.

tioner's previously established policy of obtaining stockholder approval for any substantial modification of the contractual relationship between petitioner and Reserve (Pet. App. 57a). Additionally, stockholder approval was necessary to ensure that one of the law suits, a stockholder derivative action, would be dismissed by the Delaware Court of Chancery (Pet. App. 42a). It was also necessary to ensure compliance with Title 8, Section 271, 4 Del. Code Annotated (1953), which provided in part that a corporation could sell, lease, or exchange all of its property and assets upon such terms and conditions and for such consideration as its board of directors deems expedient, "when and as authorized by the affirmative vote of the holders of a majority of the stock issued and outstanding."[4]

Petitioner did not have a fixed, unconditional and enforceable right to receive the stock until its stockholders approved the settlement on April 22, 1960, and, therefore, the income was not properly accruable until that date. Section 451(a) of the Internal Revenue Code of 1954 (26 U.S.C.); Section 1.451-1(a) of the Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.). See *United States* v. *Safety Car Heating & Lighting Co.*, 297 U.S. 88; *Lucas* v. *North Texas Co.*, 281 U.S. 11. Thus, petitioner's contention (Pet. 19) that the transaction should be considered as completed when the boards of directors approved the settlement discounts entirely the importance and legal significance of the role of petitioner's shareholders.

3. Petitioner further asserts (Pet. 9-11) that the decision below is contrary to the rationale of *United States* v. *Davis*,

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[4]Although petitioner asserts (Pet. 4-5) that the Delaware statute did not require shareholder approval, the draft of the proposed settlement dated February 18, 1960, provided that the agreement was subject to the condition that "the proposal has received the affirmative vote of the majority of all the outstanding shares of Mesabi stock [or such lesser number as the parties may agree are required by Delaware law], the shares held by Reserve not to be voted," and the parties did not agree upon a lesser number.

370 U.S. 65. There, in 1954, the taxpayer, apparently on a cash basis, and his then wife agreed to a voluntary property settlement and separation agreement providing for, *inter alia*, the transfer of certain of taxpayer's property, including 1,000 shares of DuPont stock, to his wife. One-half of this stock was transferred in the tax year involved, 1955, and the other half was transferred thereafter. This Court, having first determined that the transaction was a taxable event, held that the measurement of the taxable gain realized by that taxpayer was the value of the stock *at the date of its transfer*. The *Davis* measurement of the cash basis taxpayer's gain as of the date of the transfer is directly analogous to the Court of Claims' decision here that the value of the stock petitioner received should be measured as of the date it acquired a fixed and enforceable right to receive the stock and upon which it was required to accrue its receipt into income. Thus, *Davis* supports rather than conflicts with the decision below.

4. Contrary to petitioner's additional assertion (Pet. 15-17), the Court of Claims correctly concluded that the enhancement principle in determining just compensation in condemnation cases should not be extended to this situation (Pet. App. 21a-23a). In discussing the rules governing the determination of just compensation this Court in *United States* v. *Cors*, 337 U.S. 325, 333-334, stated:

> It is not fair that the government be required to pay the enhanced price which its demand alone has created. That enhancement reflects elements of the value that was created by the urgency of its need for the article. It does not reflect what "*a willing buyer would pay in cash to a willing seller,*" * * * *in a fair market.* * * * [T]he enhanced value reflects speculation as to what the government can be compelled to pay. That is a hold-up value, not a

fair market value. That is a value which the government itself created and hence in fairness should not be required to pay. [Emphasis added.][5]

The foregoing description of the rationale of the enhancement principle demonstrates that it was developed to deal with the special situation in condemnation where the alleged value did not reflect an arm's-length price. But that rationale has no application to the question in this income tax case as to which of two measures, representing the fair market value of stock at different times, should be used by the recipient of such stock. At all events, as the Court of Claims noted, the enhancement rationale would not have been applicable on the facts because (Pet. App. 22a): (1) if the value of the shares was enhanced because of the settlement, unlike the condemnation cases, that enhancement was due to the actions of both petitioner (the buyer) and Reserve (the seller) and the increase was not attributable to petitioner's special need for the property which itself pushed the price upwards; (2) petitioner did not prove what part of the increase was due to the settlement and what part to Reserve's separate plan to increase production and petitioner's change-over from corporate to trust form; and (3) petitioner could have resold the stock at its enhanced value and reaped the benefits of the enhancement.[6]

5. Finally, petitioner argues (Pet. 5, 11, 17-19) that use of the accrual date as the valuation date leaves the parties unable to determine in advance the tax consequences of a transaction in which actively traded stock is exchanged. The Court of Claims correctly rejected this contention,

[5] See also *United States* v. *Reynolds*, 397 U.S. 14, 16-18.

[6] While petitioner asserts (Pet. 17) that the reduction in outstanding shares would tend to cause the market price of the remaining shares to rise, there is no probative evidence in the record to support that assertion.

observing (Pet. App. 14a) that "the participants could agree on a purchase price and provide that it would be paid in 'x' shares of stock at the market price on the final date of agreement plus or minus a cash balancer."

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

FEBRUARY 1976.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-922

BANKERS TRUST COMPANY, ET AL., *Petitioners*

v.

UNITED STATES OF AMERICA, *Respondent*

On Petition for Writ of Certiorari to the United States Court of Claims

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PETITIONERS' REPLY MEMORANDUM

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PETITIONERS' REPLY MEMORANDUM

Petitioners submit the following in reply to Respondent's Memorandum in Opposition:

1. Respondent argues that the February 19 agreement was merely "preliminary" and "conditional" and that the settlement produced "nothing of substance" (Memo. 3) until ratified by the shareholders. In fact the February agreement was recognized by both sides as the final settlement of the long Reserve-Mesabi dispute. Because of the Mesabi negotiators' contacts with the Mesabi shareholders, both Reserve and Mesabi knew that once the settlement was agreed by the Boards of Directors, Mesabi shareholder ap-

proval was certain (App. 31a-33a). Prior to the shareholder vote the parties announced the settlement terms, the proposed transformation of Mesabi into a trust, Reserve's expansion plans, and quadrupled earnings projections for Mesabi. As a result, the price of Mesabi stock doubled. Only in a world of unrealistic abstractions is all this "nothing of substance."

2. The discussion in Respondent's memorandum (Memo. 4-5) of *Herbert J. Investment Co.,* 360 F. Supp. 825 (E.D. Wis. 1973) affirmed per curiam, 500 F.2d 44 (7th Cir. 1974), barely acknowledges that decision's approval of an early valuation date "despite the existence of future contingencies." Respondent attempts to distinguish that case on the ground that the court there used the date at which "temporary control was assumed by the purchaser." (Memo. 4) *Herbert J. Investment* involved transfer of a going business. In such a situation, an immediate transfer when the last practical obstacle—interim ICC approval—was cleared was appropriate to assure preservation of the business goodwill. Here Reserve had undertaken to transfer the Mesabi shares free of encumbrances (Pet. App. 54a) and an immediate transfer of the share certificates was wholly unnecessary.

The relevance of *Herbert J. Investment* to this case is the reasoning behind the choice of the earlier date for fixing value despite the fact that formal closing was deferred pending final ICC approval:

> "The parties recognized the importance of final [ICC] approval, but were so certain of its forthcoming that they fully committed themselves to the impact of their agreement [on the earlier date] and treated the possible failure of final approval as a real, but highly unlikely, condition subsequent." 360 F. Supp. at 827.

In the present case the parties "fully committed themselves to the impact of their agreement" when the agreement was reached. And the parties could be confident that the remaining contingency could be ignored since it involved only an affirmative vote of stockholders (many of whom had already indicated their approval), as contrasted to approval by an independent government agency.

3. In 1960 the Mesabi management was advised by Delaware counsel that stockholder approval of the settlement was not required by Delaware law. (Tr. 71) Contrary to Respondent's suggestion (Memo. 6), that conclusion was correct. For dismissal of a derivative action, the Delaware rules required only shareholder notice and approval by the court, not approval by shareholders. Del. R. Civ. P. 23(c); *Perrine* v. *Pennroad Corp.,* 47 A.2d 479, 486 (Del. 1946), cert. denied, 329 U.S. 808 (1947). Nor did section 271 of the Delaware Corporation Law, which related to sales and leases of all of a corporation's property, mean that stockholder approval was legally required for the agreement with Reserve, which merely modified the royalty under an existing lease.[1]

[1] The 1939 resolution authorizing the leases to Reserve gave Mesabi officers broad powers to make such further agreements "as in their judgment . . . may be necessary, advisable or proper in order to carry out the terms of [the 1939 agreements] according to the intent and purpose of these resolutions." [Stip. Ex. 4] Pursuant to that power and their general authority, Mesabi officers had, in February 1956, entered into an agreement settling some disputes with Reserve. [Pet. App. 40a-41a] The officers' authority to manage the leases and settle disputes without express shareholder approval, exercised in the 1956 settlement, covered the 1960 settlement. *Cf. Clarke Memorial College* v. *Monaghan Land Co.,* 257 A.2d 234 (Del. Ch. 1969); *Robinson* v. *Pittsburgh Oil Refg. Corp.,* 126 A. 46 (Del. Ch. 1924).

4. *Davis* v. *United States,* 370 U.S. 65 (1962), does not, as Respondent suggests (Memo. 7) stand for the rule that property is valued as of the date of transfer, but for the common sense rule that the values of properties exchanged in a transaction "are either equal in fact or are presumed to be equal." 370 U.S. at 72. Petitioners maintain that logic requires that such equality be measured as of the time the parties agree, not two months later.

5. Respondent opposes the application of this Court's "enhancement principle"—which holds that the very event which requires that a value be determined must not be permitted to affect value—on the ground that the rule applies only in condemnation cases. But Respondent ignores this Court's teaching that the same valuation principles apply in both tax and condemnation cases. *Great Northern Ry. Co.* v. *Weeks,* 297 U.S. 135, 139 (1936).

6. Finally, the Respondent airily dismisses the serious uncertainty which the Court of Claims' decision produces in assessing the economic and tax consequences of business transactions. The Memorandum suggests that had the parties wished to know the tax consequences of their agreement when they entered into it, they should have "agree[d] on a purchase price and provide[d] that it would be paid in 'x' shares of stock at the market price on the final date of agreement plus or minus a cash balance." (Memo. 9, quoting Pet. App. 14a) But here such a price agreement would have been a wholly different transaction from that to which the parties actually subscribed. Nothing in the Internal Revenue Code or the applicable court decisions suggests that it was ever the intention of

Congress to require taxpayers to use some particular form for a transaction if they wish to foresee the tax effects of their agreement.

Respectfully submitted,

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